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THE IMPACT OF INSTITUTIONAL INVESTORS ON CORPORATE GOVERNANCE, TAKEOVERS, AND THE CAPITAL MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON SECURITIES

OF THE

COMMITTEE ON

BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

THE ROLE OF THE INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE AND CAPITAL MARKETS

OCTOBER 3, 1989

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THE IMPACT OF INSTITUTIONAL INVESTORS ON CORPORATE GOVERNANCE, TAKEOVERS, AND THE CAPITAL MARKETS

TUESDAY, OCTOBER 3, 1989

U.S. Senate,
Committee on Banking, Housing, and Urban Affairs,
Subcommittee on Securities,
Washington, DC.

The subcommittee met at 9:35 a.m., in room SD-538 of the Dirksen Senate Office Building, Christopher J. Dodd (chairman of the subcommittee) presiding.

Present: Senators Dodd, Shelby, Kassebaum, Pressler, Heinz, Wirth, Bond, and D'Amato.

OPENING STATEMENT OF SENATOR DODD

Senator Dodd. The Subcommittee will come to order.

I would like to welcome everyone to our hearing on the impact of institutional investors on corporate governance, takeovers, and capital markets.

This morning, we hope to explore a question that has tremendous implications for our economy. Let me try to frame it as simply as I can.

Just how do we promote good corporate management?

And, by that, I mean the kind of management that fosters productive, competitive, job-creating companies that do the research and make the capital investments necessary for future growth, in an environment where our major corporations are controlled by institutional investors and professional money managers.

Someone would suggest that it just is not possible under our current system. It is argued that the major decisions on the part of institutional investors are made by fund managers who are more interested in beating the DOW on a quarter to quarter basis than in the long-term prospects of the companies in which they invest.

Others would suggest that institutions, particularly pension funds, which are the largest group of institutional investors, can and should be a source of patient capital, willing to provide funds for the long-term.

For many years, we have talked about corporate accountability to shareholders. We have never before—never until recently—talked about the responsibilities of share ownership.

For many years, since the work of Berle and Means in the 1930's, we have thought of shareholders as diverse, powerless individuals. Only recently have we considered the impact that a determined group of institutional investors can have on the governance of our major corporations.

For years, we have talked about shareholder rights. Only recently we have begun to ask just who those shareholders are.

The latest numbers indicate that by the year 2000, perhaps two-thirds of all corporate equities will be held by institutional investors, and the majority of those will be pension funds. This is a dramatic development. That means the retirement benefits for millions of Americans will be the seed money for capital formation in this country for the foreseeable future. And it means that fiduciaries of those funds will have the power to direct the way our major corporations are governed and managed.

It is important that we understand fully the implications of this trend.

Let me give special thanks to our witnesses. There are quite a number of you this morning, and I apologize for having all of you lined up here at one table. We tried to do something a little bit different here this morning; rather than just listening to each one of you one at a time, we'd rather create more of a round table environment.

So, this will be a bit more informal than your traditional hearing.

What I'd like to do is hear from each one of you briefly. I've read all of the testimony from those of you who submitted it early, and some of it is rather lengthy. It's valuable to us, but rather than having you read it, I've asked in advance for summations so you can paraphrase what you'll be sharing with us.

Then, we want to actually get some conversation, not only between the members of this Committee and the witnesses, but between the witnesses as well. You know these issues certainly as well and, in most cases, far better than most of the members—with all due respect to my colleagues who sit here—given the amount of interests they have to become involved with.

So, I want to encourage you in that kind of a format here this morning.

Also, I must say, this panel represents some of the best thinking in our country on these important questions. I also want to thank Dr. Carolyn Brancato who was formerly with the Congressional Research Service and who is now in private practice, who wrote an excellent introductory piece for the hearing. That will be included in the hearing record.

[The report referred to follows:]

INSTITUTIONAL INVESTORS AND CORPORATE AMERICA: CONFLICTS AND RESOLUTIONS

AN OVERVIEW OF THE ROLE OF INSTITUTIONAL INVESTORS IN CAPITAL MARKETS AND CORPORATE GOVERNANCE

PREPARED AT THE REQUEST OF THE

SUBCOMMITTEE ON SECURITIES

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

BY

DR. CAROLYN KAY BRANCATO

INSTITUTIONAL INVESTOR PROJECT

COLUMBIA CENTER FOR LAW AND ECONOMIC STUDIES

OCTOBER 3, 1989

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INSTITUTIONAL INVESTORS AND CORPORATE AMERICA: CONFLICTS AND RESOLUTIONS

AN OVERVIEW OF THE ROLE OF INSTITUTIONAL INVESTORS IN CAPITAL MARKETS AND CORPORATE GOVERNANCE[1]

INTRODUCTION

The term "Institutional Investor" defies precise definition, and becomes increasingly elusive in a dynamic capital market.[2] By any measure, however, institutional investors have, during the past fifteen years, increased substantially their assets, their trading activity on major stock exchanges and elsewhere, and their percentage ownership of American corporations.

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[1] This report is based primarily on research and extensive on-going dialogue at the Institutional Investor Project, Columbia Center for Law and Economic Studies. The Project was established in January of 1988 to study the role of institutional investors in corporate America and to provide a center for institutional investors and corporations to exchange views and work towards harmonizing their differences. Ira M. Millstein is Chairman of the Board of Advisors of the Center and Professor Louis Lowenstein is the Director of the Project. The author of this report, Dr. Carolyn Kay Brancato, was formerly a senior economist with the Congressional Research Service and is currently Director of the Columbia Institutional Investor Project's Data Collection Project and Chief Economist at the law firm Weil, Gotshal & Manges. This report is not intended to advocate any position, but rather to provide background information and discussion of public policy options.

[2] The definition of the "institutional" investor, as distinct from the "individual" investor generally revolves around the fact that money is being professionally -- or institutionally -- managed. Research at the Institutional Investor Project, Columbia Center for Law and Economic Studies, indicates that the principal categories of institutional investors include private pension funds, state and local retirement funds, mutual funds, closed end investment trusts, life insurance companies, property and casualty insurance companies and non-pension fund money managed by banks and foundation and endowment funds. Needless to say, this definition conservatively represents the institutional investor universe, since it may not fully capture certain pooling of money through innovative financing techniques recently developed in the investment community. See: Brancato, Carolyn Kay and Patrick A. Gaughan. The Growth of Institutional Investors in U.S. Capital Markets. Institutional Investor Project. Columbia Center for Law and Economic Studies. November, 1988. p. 3.

These changes have precipitated questions about the increasing importance of these institutional investors in capital markets; their effect on volatility, liquidity, and stability of these markets; their effect on the allocation of capital resources in the economy; and their effect on the very heart of our corporate governance structure. Finally, with mounting takeover activity during the 1980's, interest has been most acute in change-of-control situations, and in how these institutions wield their increasing economic power vis a vis the corporations in which they hold equity and other types of assets.

The Separation of Ownership and Control

Yet, at the same time this market influence has been growing, there is a perception that fiduciary control over institutional investor buying, holding, and trading patterns has, for some institutional investors, been diminishing. The report of the New York State Governor's Task Force on Pension Fund Investment has articulated this concern over increased separation of economic power and economic control.[3] Exhibit 1, from this report, describes how ownership and management of assets has changed from historical corporate models, where ownership was concentrated among those owners who were usually managers, to current corporate models where share ownership is concentrated in pension funds managed by trustees on behalf of beneficiaries.

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[3] See: The Report of the Governor's Task Force on Pension Fund Investment. Our Money's Worth. Governor Mario M. Cuomo, Chairman Ira M. Millstein, Director Lee Smith. June 1989.

This separation of ownership and control arises from a number of factors, including the perception that some fiduciaries have been encouraged, directly or indirectly, by the Employee Retirement Income Security Act (ERISA) to delegate certain of their financial decisions to money managers.[4] Many of these money managers, in turn, are perceived to be interested primarily in maximizing short-term profit, frequently at the behest of the plan sponsors themselves, who measure their investment managers' performance based on short-term results.

The specter of a large corporate pension fund delegating funds to an investment manager who, wishing to take advantage of highly favorable rates of return, places those funds in certain investments, such as LBO blind pools organized for the purpose of launching a hostile LBO-related tender offer for that very company, is perhaps an extreme case. But that this would be possible, raises the most fundamental concerns about separation of control and management of financial resources.

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[4] See, for example: The Department of Labor's Enforcement of the Employee Retirement Income Security Act (ERISA). A Report by the Subcommittee on Oversight of Government Management of the Committee on Governmental Affairs. U.S. Senate. Committee Print 99-144. 99th Congress. Second Session. April 1986. pp. 43-68.

A Financial "Ecosystem"

With the staggering growth in assets under management of institutional investors, some have argued that these assets have become, in effect, the capital formation seed money for the country.[5] Furthermore, in certain instances, individual transactions in capital markets may well have become so large as to produce "spillover" effects (both negative and positive) on the economy at large. Thus, for example, the bond market for many types of high grade industrial bonds reacted negatively to the "event risk" of the RJR Nabisco leveraged buyout transaction (in which layers of new debt would dilute the asset base for existing bondholders of RJR, causing concern that no other corporation was immune from a similar deterioration in the value of its bonds.) The size of recent innovative financing transactions, as well as the size of the major participants, especially the large corporations and the large private and public pension funds, requires that we no longer view specific individual transactions in isolation. Rather, they must be seen as part of a financial "ecosystem" in which a delicate balance between members of the community must be maintained in order for the system to survive and flourish.[6]

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[5] Report of the Governor's Task Force, pp. 1-13.

[6] For a discussion of "external effects" on capital markets stemming from individual transactions see: Brancato, Carolyn Kay. Leveraged Buyouts and the Pot of Gold: 1989 Update. Subcommittee on Oversight and Investigations. Committee on Energy and Commerce. U.S. House of Representatives. 101st Congress. First Session. Committee Print 101-K.

"A Paradox, A Paradox, A Most Ingenious Paradox"

As one more closely examines issues surrounding institutional investors, there appear to be many paradoxical trends. Certain public pension funds and union funds are thought to be too "activist" in wielding their power to extract concessions from corporate management (perhaps motivated by political pressures from legislative bodies overseeing, for example, public funds). Others, primarily in the private pension fund area, are seemingly too "passive" because they are perceived to be silent on corporate governance matters or they are perceived merely to vote with management (perhaps pressured by management within their own plan sponsoring company). Varying participants in the process have encouraged both types of funds to act more like "owners" rather than "traders," to assume responsibilities as owners, and not to delegate investment and voting authority to money managers.[7] Also, pension funds have been encouraged not to observe the "Wall Street Walk" or to "vote with their feet" when they don't like what is going on with a corporation. Rather, they are encouraged to use their "voice" rather than their "exit" mode.[8]

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[7] See, for example: Millstein, Ira M. The Responsibility of the Institutional Investor in Corporate Management. Conference on Corporate Governance, Restructuring, and the Market for Corporate Control. Salomon Brothers Center, et.al. New York University. May 22, 1989; and Regan, Edward V. Pension Funds: New Power, New Responsibility. Wall Street Journal. Editorial. November 2, 1987.

[8] Report of the Governor's Task Force, pp. 36-41.

But it seems paradoxical that institutional investors appear to be focused on the short-term and the long-term at the same time. Thus, on the one hand, it is argued they have a long-term focus because: (1) some funds may "index" or engage in "passive investment" strategies, which apparently puts them in a more long-term holding mode with the corporations in which they invest; and (2) others have such large holdings they are regarded to be, de facto, "the market" and therefore unable to sell their stock. On the other hand, many institutional investors are accused of being short-term oriented, and engaging in rapid turnover and trading for short-term profit, which is thought to undermine corporate long-term strategic planning.

Another puzzling aspect is that some observers claim institutional holdings have relatively little direct impact on corporate performance, investment, and planning, and that the development of "synthetic" markets[9] of derivative instruments further distances the corporation from any effective economic or capital flow relationship with its major shareholders. Thus, many contend it will be only through endeavors such as exercising voting prerogatives, or perhaps having even more direct "activist" interaction with boards of directors, that major institutional shareholders will have an impact on corporations.

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[9] Some have referred to these developments as the "commodization" of securities markets -- turning securities into "commodities". The term "synthetic" market may be preferable, to "commodities" market when applied to these derivative instruments, in view of the fact that, in commodities markets, physical delivery of product is often accomplished.

A final paradox is that investment and voting in the context of "routine" decisions may be quite different from that which is undertaken in advance of, or during, a takeover. Indeed, voting rights take on increased value in an atmosphere where contests for corporate control and major restructurings are commonplace. While the current climate of corporate governance activism was initiated in response to certain anti-takeover policies on the part of corporations, even when there is no immediate possibility of a takeover, voting rights have become infused with significant value-adding potential, and shareholders are not likely to return to former periods of benign neglect, even if they were not being prodded by the Department of Labor to consider voting a fiduciary responsibility.

These paradoxical trends, however, can coexist within a dynamic market, if that market is viewed not from the perspective of isolated individual transactions, but rather as an "ecosystem." This is possible if we assume several key factors, which will be discussed in detail in this report:

- institutional investors are not a monolithic group -- they are comprised of many various types of public and private pension funds, life insurance companies, bank trusts and the like, all of which have considerably varied risk parameters and investment objectives, which leads to varied trading and holding patterns and varied levels of interest and participation in the corporate governance process;
- along with this multiplicity of investment/voting perspectives is a multiplicity of current structures in which the institutional investor makes his/her decisions, including a wide variety of board/trustee/fiduciary/money manager/proxy advisor arrangements and a wide range of practices with respect to delegating investment and voting responsibility to named fiduciaries;

- investment and voting decisions may be undertaken differently in a more "routine" investment climate as opposed to an investment climate surrounding a contest for corporate control;
- concentrations of economic power on the part of major institutional investors in their dealings in major financial transactions can have a potentially accelerating effect on financial markets, and the economy as a whole, whether these instruments arise out of "routine" investment flows or "unusual" instances of contests for corporate control, however the boundaries of distinction between the routine and the unusual are rapidly blurring.

In the final analysis we must ask what do these institutional shareholders want from the corporations and how should corporations interact with them? There can be no doubt that tensions have been mounting, especially between public funds and corporate boards of directors. Perhaps the only thing certain is that the relationships currently being established between institutional investors and corporations will shape our capital formation and corporate governance structure now and into the next century.

In an attempt to unravel the elements of this complex subject, this report provides an overview of:

- forces interacting to bring the role of institutional investors to its current prominence, including shareholder activism;
- the dynamics of the institutional investor marketplace, including major differences and interlinkages between the principal participants;
- the debate on "who's money is it anyway" which concerns defining the appropriate "constituents" of the major institutional investor group block, the private and public pension funds;
- the significance of certain investment and trading patterns of institutional investors, and turnover patterns and investment in vehicles such as index funds;

- discussion of alternative ways for institutional investors to interact with boards of directors, including performance evaluation, representation on the board itself, and working through the board to ensure that the board is effectively functioning; and
- discussion of public policy questions including whether to clarify by regulation or modify by legislation ERISA; whether to change proxy rules as they apply to institutional shareholders, and whether to impose capital gains taxes on short-term trading.

I. INSTITUTIONAL INVESTORS: SLEEPING GIANTS?

> Pension funds, long the most staid and quiet of shareholders, have suddenly awakened to the tremendous power they command....New York state's pension fund alone can vote up to 2% of most major U.S. corporations. On the verge of become majority shareholders in corporate America, pension funds are beginning to flex their muscles.[10]

How have institutional investors come to occupy such a significant place in our capital market structure? One reason is the size and growth in the institutional investor asset base, which is daunting. This means institutional investor ability to marshall proxy voting resources is also enhanced and becomes even more critical during contests for corporate control. Finally, with increased size comes increased effects on the volatility and stability of capital markets.

Total Assets of Institutional Investors

We estimate that institutional investor asset holdings in 1988 exceeded $5 trillion and that they represented approximately 45 percent of all equities -- thus, by any measure, these institutional investors are rapidly "becoming the market."[11] (See Exhibits 2 through 4)

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[10] Regan, Edward V. Pension Funds: New Power, New Responsibility. Wall Street Journal. Editorial. November 2, 1987.

Percentage of Equity in Corporations

As a group, institutional investors hold an increasingly larger share of the equity of U.S. corporations -- in 1988 they held 52 percent of the equity of the top 50 corporations (up from 49 percent a year earlier), 53 percent of the equity in the top 100 corporations and 47 percent of the equity in the top 1,000 corporations. Corporations in certain industries tend to have higher concentrations of ownership by institutions; in 1988, aerospace, paper and transportation industries lead all industries with 58 percent institutional ownership, while utilities and telecommunications have the lowest with 35 percent institutional ownership. (See Exhibits 5, 6 and 7)

The Public and Private Pension Fund Asset Base

A major reason for the growth in the largest single institutional investor group, the public and private pension funds, is the passage of the Employee Retirement Income Security Act (ERISA) in 1974. This legislation, primarily intended to prevent abuse in the administration of pension fund assets, has fostered an atmosphere conducive to channeling significant amounts of assets into the private pension fund area. Although ERISA, which is jointly administered by the Departments of Labor and the Treasury, covers only private funds, many public state and local government fund fiduciaries follow similar guidelines for fiduciary conduct, to ensure their continued tax-exempt status under Treasury regulations, and because some state legislatures have adopted their own versions of ERISA to apply to these funds. In addition to ERISA, a series of laws allowing favorable tax treatment for pension fund assets has contributed significantly to the growth in pension fund assets.

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[11] Exhibits 2 and 3 show the growth in institutional investor assets from $2.1 trillion in 1981 to $4.64 trillion in 1987; Exhibit 4 shows that institutional investors increased their market value share of equities from 38.5 percent in 1981 to 42.7 percent in 1986; more recent unpublished estimates by the author put the current total value of institutional investor assets in excess of $5 trillion, with these investors accounting for approximately 45 percent of equities.

In 1988, public and private pension funds held over $2.3 trillion in assets, they represented approximately 44 percent of total institutional assets, and they accounted for 24.6 percent of equity markets and 15.3 percent of bond market activity. (See Exhibits 8, 9 and 10)

Growth in Public and Private Pension Fund Assets

Institutional investors have experienced unprecedented annual growth in assets exceeding 14 percent during the years 1981 through 1987. (Exhibit 2) There may be some diminishment in the future growth of private pension funds, however, as a larger percentage of these funds become more fully funded or funded in excess of projected benefit requirements. Growth in public funds, on the other hand, remains vigorous. In 1988, private trusteed pension funds grew 12.2 percent from 1987, while state and local pension funds grew 17.0 percent during the same period. (Exhibit 8).

Concentration of Economic Power Among a Relatively Small Number of Pension Funds

The largest pension funds have a high concentration of economic power. At the end of 1988, the largest 30 public and private funds had holdings of $627.7 billion, which represented approximately 27.3 percent of the total $2.3 trillion asset value of all public and private pension funds and 39.6 percent of the $1.58 trillion in assets represented by the largest 1,000 funds.

Importance as "Owners" of Equity, Especially in the Tender Offer/Proxy Process

Since the most recent takeover wave picked up momentum in the early 1980's, institutional investors, especially certain public pension funds, have become increasingly activist. Prior to that time, shareholder activism was largely comprised of individual efforts on such social responsibility issues as investments in South Africa and certain environmental concerns; institutional investors routinely discarded their proxy votes. Now, however, the fiduciary in charge of investing institutional investor money perceives this vote to be infused with significant value-adding potential, most directly in connection with change of corporate control situations. But, since either these contests or major corporate restructurings have become so pervasive, the value-adding potential of the vote appears now to be well accepted, not just in takeover contests. This portends continued increased institutional investor activity, regardless of future levels of takeover activity.

With respect to tender offers, former Securities and Exchange Commission Chairman David Ruder has noted that the institutional role in the corporate governance process also may be strengthened by the Supreme Court decision upholding Indiana's Control Share Acquisition Act. The Indiana statute, and others like it, may have the effect of turning some tender offers into proxy voting contests. As a result, shareholder votes will become more crucial in the tender offer process.[12]

Relation to Volatility in Securities Markets

The relationship between large concentrated institutional holdings and the volatility of securities markets bears considerable attention and future research. The SEC's report on the October 1987 market "break" notes that certain market basket and derivative instruments have increased the efficiency of the securities markets by substantially enhancing institutions' hedging and market timing capabilities and lowering certain transaction costs, especially in reallocating portions of the portfolio among equities and bonds.

On the other hand, the transactional and hedging efficiency of such instruments as stock index futures is associated with the development of a "synthetic" stock market for a growing number of institutional investors. These investors choose to trade passively by investing in funds tied to specific indexes. The SEC Market

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[12] Ruder, Davis S. The Impact of Institutional Investors on Large Corporations. Remarks before the 27th Annual Corporate Counsel Institute. Chicago, Illinois. October ~~11,~~ 1988. p. 12.

Break report concludes that there are data which "demonstrate the substantial impact this alternative stock market can have on the equity market, especially by increasing intra-day price volatility."[13] And, in the event that there is a "rush to the exit," as occurred in October, 1987, Ruder has noted that "[i]t should be obvious that decisions to sell even small percentages of portfolios containing $1 billion or more in New York Stock Exchange shares can result in enormous downward pressure on the stock market."[14]

II. A CHRONOLOGY OF CORPORATE GOVERNANCE ACTIVISM ON THE PART OF CERTAIN INSTITUTIONAL INVESTORS

A landmark event in the growth of shareholder activism in the corporate governance area (as opposed to activism in the more traditional "social responsibility" area) came during 1984 when Jess Unruh, then California state treasurer, organized a group of public pension funds to combat greenmail payments, golden parachutes and other defensive tactics. As corporations began to arm themselves with antitakeover defenses such as shark repellents and poison pills, certain institutional investors launched campaigns against defensive tactics they perceived would lower the value of their stock in the event of a takeover battle.[15]

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[13] Division of Market Regulation. Securities and Exchange Commission. The October 1987 Market Break. February 1988. p. 3-8.

[14] Ruder, The Impact of Institutional Investors on Large Corporations, p. 20.

The Investor Responsibility Research Center (IRRC) reported in its Corporate Governance Bulletin in September 1985 that a small, albeit growing, number of shareholders were registering negative votes on such issues as blank check preferred stock, poison pills, and antigreenmail provisions, including whether any of these antitakeover defenses could be instituted without shareholder approval.

Just a year later, the IRRC reported that four large pension funds had launched attacks, through voting on shareholder resolutions, on selected antitakeover measures at some 60 corporations; these funds included the California Public Employees' and Teachers' Retirement Systems, the State of Wisconsin Investment Board, the College Retirement Equities Funds (CREF), and several pension funds administered by the United Brotherhood of Carpenters and Joiners of America.[16]

By 1989, according to the IRRC, institutional investors had "broadened their activist approach in the 1989 proxy season, in some cases conducting full-scale proxy fights against management proposals, practices or board nominees." Altogether, shareholders have submitted more than 225 major corporate governance proposals and 200 social responsibility proposals this year.[17] The shareholder vote on proposals to redeem or put pills up for shareholder ratification was 39.8 percent at 11 companies -- up significantly from the approximately 11 percent four years ago.

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[15] There has also been a rise in the number of institutional shareholder groups to organize institutional investor activity (primarily public fund activity). These groups include the Council on Institutional Investors (CII) whose executive director is Sarah Teslik, United Shareholders Association (founded by T. Boone Pickens) and Institutional Shareholder Services (ISS) founded by former Department of Labor official Robert Monks.

[16] O'Hara, Peg. Pension Funds Launch All-Out Attack on Poison Pills. Corporate Governance Bulletin. Investor Responsibility Research Center. Vol. III, No. 4. November/December 1986. pp. 86-89.

Recent watershed developments in the corporate governance area include:

- In January 1989, Texaco appointed pension fund nominee John Brademas to its board of directors. This action was reported to have been taken to fulfill a promise made [illegible] certain institutional investors during the 1988 proxy battle with dissident shareholder Carl C. Icahn, in return for an agreement by certain large institutions to vote with management against Icahn.

- At Exxon, certain shareholders threatened to withhold their votes from the board to protest the Alaska oil spill and the company's handling of the cleanup. New York City Comptroller Harrison J. Goldin led a delegation of institutions, which held about 22 million Exxon shares, to meet with company executives. On May 11, 1989, Exxon agreed to name an environmentalist to its board of directors.

- In September, 1989, management of UAL Corporation, in an apparently successful effort to thwart a takeover bid by financier Martin Davis, agreed to a joint labor management buyout with representation of 3 labor-appointed directors, together with 3 from management, 8 independent directors, and 1 from British Airways.

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[17] O'Hara, Peg. Institutional Activism Hits New High in 1989 Proxy Season. Corporate Governance Bulletin. Investor Responsibility Research Center. Vol. IV, No. 3. May/June 1989. p. 66.

- During the first part of 1989, according to the IRRC, several large public pension funds joined in a group that waged a successful proxy solicitation against two management proposals at Honeywell.

- Also in 1989, labor unions spearheaded proxy fights against management at Pittston and for a seat on the board at Pacific Enterprises.

- Finally, institutional shareholders at Time Inc. and Warner Communications are reportedly currently meeting to discuss what some regard as shareholder disenfranchisement. This follows the Delaware Chancery Court's decision in July, 1989, to uphold action taken by Time and Warner to reconstitute their merger transaction to thwart a competing bid by Paramount. The court ruled that directors of a publicly held corporation are not required to abandon a long-term strategy, e.g. their long-term plans to merge Time with Warner, in order to auction the company in a takeover situation. Time and Warner had proposed a merger in the form of a stock-for-stock exchange, contingent on stockholder approval. When Paramount announced an all share, all cash tender offer for Time, Time then recast the Warner transaction in a way so as not to require stockholder approval; it abandoned the stock-for-stock approach and made a cash offer for 51 percent of Warner.[18]

III. INSTITUTIONAL INVESTORS ARE NOT A MONOLITHIC GROUP

Research at Columbia indicates that categories of institutional investors have widely divergent investment and risk objectives, and therefore employ: (1) varying asset allocations among equities, bonds and others types of financial instruments; and (2) varying investment strategies for monies within each asset allocation category.[19] For example, life insurance companies are more risk averse and have greater requirements for stability of long-term return; therefore, they put smaller percentages of their assets into equities (and typically equities of lower risk) than do pension funds.[20] (See Exhibits 3 and 9 through 12)

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[18] Directors May Reject Tender Offer In Order to Pursue Long-Term Goals. Bureau of National Affairs. Corporate Counsel Weekly. Vol. 4, No. 29. July 19, 1989. p. 1.

[19] Brancato and Gaughan, The Growth of Institutional Investors in U.S. Capital Markets, pp. 12-13.

Furthermore, even within the same category of institutional investor, e.g., the pension fund category, funds have many different characteristics, including methods and investment philosophy, investment and voting decision making structure, and interaction with various consultants and money managers.

Private Pension Plans

The Employee Benefit Research Institute has described the major types of private pension plans:[21]

- Private Trusteed Plans are pension funds managed by a trustee appointed by the plan sponsor, which may be an employee of the plan sponsor, or may be a bank or trust company. Contributions are placed in a trust set up exclusively for the pension plan. In a defined benefit plan the investment risk is borne by the plan sponsor, who must adjust contributions according to any actuarial losses (or gains) that occur. In a defined contribution plan, plan participants, who often have some say in the investment of contributions to their individual accounts, bear the investment risk; investment performance is reflected in the balance of their individual accounts.
- Private Insured Pension Funds are managed by life insurance companies. The insurance company and plan sponsor enter into a contractual agreement under which

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[20] Exhibit 3 shows that life insurance companies devoted 9.7 percent of their 1986 assets to equities, whereas pension funds devoted 35 percent of their assets to equities. Exhibits 9, 10, 11 and 12 contain information regarding asset allocations of various types of pension funds.

[21] Excepted from: EBRI Quarterly Pension Investment Report. Employee Benefit Research Institute. First Quarter, 1989. Vol. 4, No. 1. June, 1989. p. 62.

the sponsor pays premiums to the insurance company, which, in return, guarantees payment of future benefits. The plan sponsor may choose to transfer all investment decisions and risk to the insurer, or may choose to share in investment decisions and investment gains and losses.

Funding Levels

Many private pension funds have accumulated surplus assets which exceed benefit levels required to be paid out. In addition, some have pension fund asset accumulations which are significant in proportion to corporate assets and shareholders' equity. (See Exhibit 13) As one would expect, there is considerable controversy surrounding uses to which surplus assets may be put, although a discussion of this subject is beyond the scope of the present report. Exhibit 13 also indicates there exists a wide range of accrued benefit obligations compared to projected benefit obligations, with some plans in surplus and others in underfunded positions.

Models for Investment and Corporate Governance Decision Making

Private plans, for example those sponsored by corporations, may have a variety of models for interaction between the board of directors and the plan fiduciary designated under ERISA. Options include variations on at least the three following models, with the possibility of combining one or more model at the same institution at the same time (e.g. the second and third options can exist at the same time if part of the portfolio is invested in-house and part delegated to money managers).

* The Board sets policy with respect to investment and corporate governance/proxy guidelines to be followed by the fiduciary and delegated fund managers;

- The Board delegates these decisions to fiduciary who monitors investment and/or proxy voting on an in-house basis;
- The named fiduciary delegates investment and/or proxy decisions to consultants[22] and/or money managers/and or proxy advisory firms with varying degrees of input and feedback.[23]

Public Pension Plans

Public pension plans are generally run subject to state laws stipulating contribution and benefit levels, with any shortfall to be made up from general state revenues. Instead of boards of directors, these funds frequently have trustees; the structure varies by state, with certain states having a sole trustee, and others with multiple trustees, some of whom are elected and some appointed by various state officials. Similar controversies exist as to what to do with surplus funds (although the state budget is the analogy to the corporation's capital account), and a similar range of models for investment and proxy voting exists. Also, money may be managed in-house or delegated to any combination of consultants and/or money managers and/or proxy advisory firms, just as in the private pension fund sector -- often to the same groups of consultants and/or money managers and/or proxy advisory firms.

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[22] In the investment cycle, consultants frequently advise funds on a variety of matters, including the allocation of the portfolio among different types of assets. Money managers may serve the same function, although a fiduciary frequently follows a two-step process by working with the consultant first, to determine overall portfolio allocation, then placing amounts for investment within specific categories with single or multiple money managers. Of course, some fiduciaries will make these decisions on an in-house basis.

[23] Many proxy advisory firms establish their own set of guidelines for voting the proxies of stock delegated to them as voting fiduciaries, in accordance with what they perceive to be the objectives of the plan sponsor; some many consider specific guidelines of the plan sponsor, but others, especially if stock is co-mingled and proxies voted in blocks, are reluctant to follow specific instructions from the plan sponsor as to how to vote an individual proxy.

IV. WHOSE MONEY IS IT ANYWAY?

One of the most heated topics of current debate is defining the appropriate constituents of pension fund fiduciaries -- an issue which has, with increased pension fund asset size and voting power, become much more than academic. At the center of the controversy are two questions: (1) for whom should the fiduciary manage the money?; and (2) what investment and voting strategy should be pursued to fulfill the objectives of this constituency? In evaluating these objectives, as noted above, "routine" investment decisions may be considerably different from those a fiduciary is called upon to make during a contest for corporate control.

The basic law pertaining to the investment of pension fund money is the Employee Retirement Income Security Act of 1974 (ERISA).[24]

> ...ERISA contains rules governing the conduct of fiduciaries of employee benefit plans. ERISA has general rules relating to the standard of conduct of plan fiduciaries, and also specific rules prohibiting certain transactions between a plan and parties in interest with respect to the plan, such as a plan fiduciary. Plan participants as well as the Department of Labor may bring suit to enforce the fiduciary rule. Plan fiduciaries are personally liable under ERISA for any losses to a plan resulting from a breach of fiduciary duty. A court may also impose whatever equitable or remedial relief it deems appropriate for a violation of the fiduciary standards.[25]

According to the general fiduciary standards under ERISA, pension fund fiduciaries must discharge their duties and invest money: (1) solely in the interests of the plan participants and beneficiaries; (2) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable administrative expenses of the plan; and (3) with the care, skill, prudence, and diligence under the circumstances then prevailing, that a prudent person, acting in a like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims.

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[24] Within the Department of Labor (DOL), the Pension and Welfare Benefits Administration (PWBA) administers certain provisions of ERISA, while the Department of the Treasury oversees other provisions; and DOL and Treasury jointly administer still others. The PWBA is responsible for protecting the rights of approximately 65 million individuals covered by ERISA and about 1.3 million Federal employees currently enrolled under the Federal Employees' Retirement System (FERSA), also explicitly covered by ERISA. Annual Report of the Office of Inspector General. U.S. Department of Labor. October 1, 1988 - March 31, 1989. (This report states that DOL believes it has insufficient manpower to enforce certain of ERISA's provisions).

[25] Overview of Present Law Relating to the Investment of Pension Plan Assets. Prepared by the Staff of the Joint Committee on Taxation. July 7, 1988. Report No. JCX-14-88.

ERISA directly applies to private pension funds, while state funds are not directly subject to ERISA. State funds, however, "are often subject to similar standards under the common law or state statutes. In addition, federal tax-exempt status for public and private pension systems depends upon compliance with the federal tax code, which includes an 'exclusive benefit rule.'"[26]

Two issues emerge: (1) how broadly should the Departments of Labor and Treasury interpret the language pertaining to managing the assets for the "sole" or "exclusive" benefit of plan participants and beneficiaries, in other words with what degree of peripheral vision can fiduciaries view those to whom they owe a duty?; and (2) what range of investments does the language of ERISA permit, in other words does a fiduciary have to "maximize" his/her returns or are "optimization" strategies permissible and "safe" for a fiduciary facing a possible surcharge?

Shareholders v. Stakeholders

Opposing positions are emerging. The first point of view stems from a more strict view of ERISA's "exclusive" benefit provisions. This point of view has come to be known as the "stockholder" approach; advocates argue that investment and corporate governance voting actions should be taken solely on behalf of the named beneficiaries. A newer approach was adopted by the New York State Governor's Task Force, which reasoned that the beneficiaries of a plan are affected by a number of factors pertaining to the climate in which the corporation does business, and to the long-term viability of the corporation, its current employees and its future retirees.[27] (Exhibit 14 presents a chart representing this broader "stakeholder" approach.)

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[26] Report of the Governor's Task Force, p. 21.

Advocates of the shareholder approach worry that the stakeholder view will be too broad, and will permit private and public pension fund money to be used either for the benefit of corporate management, or for "social" investing by a state political body, respectively. Either approach will, they argue, undermine the original objectives of the plan, which is to provide security of retirement income. They also claim those who advocate the stakeholder view may be justifying turning down a tender offer premium to invest in the "long-term" in order to entrench management.[28]

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[27] In July, 1989, the Governor of New York State also signed legislation designed to clarify that directors of New York companies can consider the effect of a merger or acquisition on their employees, customers and creditors -- e.g. the "stakeholders" of the corporation. The law also clarifies that directors may consider the effect of a bid on their firm's potential growth, development, productivity and profitability. Critics of the stakeholder statue say it is a guise that permits management entrenchment, since there are now more factors that can be weighted when responding to an offer, which will, in turn, make it harder for shareholders to challenge the boards' decisions. Legislative Toss-Up: Effect on "Stakeholders" is Factor to Consider in Takeovers. New York Law Journal. July 6, 1989. p. 5.

With respect to the "take the premium and run" tender offer issue, the Departments of Labor and of Treasury issued a joint statement in January of 1989, explaining their view of the applicability of ERISA's fiduciary duties to tender offer and proxy contests. The statement explicitly recognizes that fiduciaries are not automatically obligated to accept a tender offer merely because it exceeds the current market price. Rather, fiduciaries are obligated to examine the underlying intrinsic value and long-term business plan of the target company. This frees fiduciaries from the requirement passively to accept a tender offer and authorizes them actively to engage in discussions with the corporation regarding the long-term prospects of the current management. (Note: in its March 2, 1989 Proxy Project Report, the Department of Labor stated its view that the ERISA rules governing the allocation of investment responsibility apply not merely to investment decisions, but to proxy voting as well, thus recognizing proxy voting as part of the fiduciary function of plan asset management.)

But many view the January DOL-Treasury joint statement as falling short of addressing the emerging national public policy considerations of the stakeholder approach. They maintain the beneficiaries of pension plans will benefit from a prudent, albeit broader, approach to investing which removes the "blinders" and extends the fiduciary's "peripheral vision" to take into consideration various other constituencies of the corporation, while still having as its objective maintaining the viability of the retirement income stream. This can be done, they argue, by ensuring the corporation, and the general climate in which the corporation functions, has long-term viability.

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[28] Certain shareholder rights groups such as the Institutional Shareholder Services (ISS) and United Shareholders Associate (USA) generally subscribe to these positions.

Maximizing v. Optimizing and the "Social Investing" Controversy

How broadly one defines "sole" or "exclusive" benefit will certainly have an impact on the types of investments a fiduciary will undertake. This leads us to the "social investing" controversy. Certain shareholder rights groups maintain that allowing a broadened stakeholder definition under ERISA will open the Pandora's box of social investing or, notwithstanding ERISA's self-dealing prohibitions, encourage patronage in investment decision making. They argue that, if investments were attractive with appropriate risk-return features, fiduciaries should and would invest. But, if investments can not stand on their own merits, they should not be made, under the theory that, if the state wishes to subsidize certain projects, it should do so directly, not through the pension systems of its public government and/or private corporate workers.

On the other hand, advocates of the stakeholder approach maintain that the fiduciary has an obligation to "optimize" returns, not necessarily "maximize" them. This view rests on the assumption that the modern U.S. corporation, to compete effectively in world markets and promote real economic growth over the long-term, must change its perspective from immediate profit-driven "maximizing" actions (such as delaying research and development expenditures which might temporarily depress stock prices) to longer-term "optimizing" strategic planning approaches.[29] Furthermore, they maintain that the stakeholder approach is not social investing and that, if a state wishes to undertake a project with below market return, it should guarantee the return to the pension fund making the investment. Finally, the broader concept of stakeholders allows the fiduciary to take into consideration many of the same constituents corporate boards of directors have had to consider for many years.

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[29] See: Report of the Governor's Task Force. Also note: Deputy Secretary of the Treasury Peter McPhearson has stated that "U.S. management should have a balanced decision-making horizon -- short and long-term -- in order to preserve and advance our competitive position in the world." Also, since pension funds have a huge and growing ownership stake in U.S. corporations, they "are in an ideal position to help assure that American management takes a balanced time-horizon approach to running their companies." Washington Post. U.S. Prods Pension Funds Towards Long-Term Planning. April 5, 1989. (Quoting Deputy Treasury Secretary M. Peter McPhearson).

V. TRADING AND INVESTMENT PATTERNS

Do institutional investors have a short-term or long-term investment horizon? What are their trading and turnover patterns? How pervasive are new forms of investments such as indexes, derivative instruments, and stock which separates out voting rights? To what extent do these instruments contribute to a short- or long-term perspective? Or to the exercise of shareholder responsibilities to vote?

The Issue of Turnover and Investing for the Short-Term v. the Long-Term

Many argue that increased institutional investor turnover evidences a short-term investment horizon. Exhibit 15 presents turnover data from the New York Stock Exchange which indicates that turnover of NYSE shares listed rose from 19 percent in 1955 to 55 percent in 1988 (after spiking at 73 percent during 1987, the year of the crash). Professor Louis Lowenstein, in his book "What's Wrong With Wall Street?" maintains that NYSE turnover data vastly understate actual trading activity by institutional investors, since these data measure only equity turnover and not trading in more volatile derivative instruments.

Exhibit 16 shows turnover by corporation for the top 50 corporations, ranked by stock market value. These turnover data are remarkably similar to the broader based NYSE data, with a 1987 spike of 74 percent, dropping down to 56 percent in 1988. (Turnover was 68 percent for the top 50 corporations in 1986.)

Exhibit 17 covers data from the Spectrum data base for the top

875 investment advisors[30] filing 13F forms with the Securities and Exchange Commission for the four quarters ending June, 1989.[31] These investment advisors, with investment discretion of at least $100 million, include public and private pension funds which manage any or all of their own money, bank trusts, insurance companies, and mutual fund managers. Annual turnover is shown from September 1988 through June 1989, and advisors are ranked beginning with the highest percentage turnover for the equity portion of their portfolios. Turnover ranges from approximately 400 percent (the stocks in the portfolio are traded four times per year) to turnover of less than one percent (less than one percent of the stock was traded during the year).

Of the 875 investment advisors, only 119 or 13.6 percent experienced turnover of 100 percent or more. On the other hand, 415 investment advisors or 47 percent of the investment advisors had turnover under 40 percent, and 160 investment advisors or 18.3 percent of the total had turnover under 20 percent. These data, with their wide variation, underscore the proposition that institutional investors are not a monolithic group. Thus, it can be seen that turnover varies widely for the equity portion of portfolios under management by various public and private pension funds, and by various types of institutional investors. All 875 investment advisors had an average turnover of 40.2 percent, while the 208 bank trust departments filing 13F forms had the lowest turnover of 26.7 percent, the 65 insurance companies had slightly higher average turnover of 33.9 percent, and the 460 in the general category of investment advisors had the highest average turnover of 61.7 percent.

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[30] Data on only the top 837 are shown, because of the length of the exhibit, and the de minimis turnover numbers of those ranked lower than 837.

[31] In 1975, the Securities and Exchange Act of 1934 was amended to provide for more public disclosure of institutional investment activities. As a result, Section 13(f) was adopted, requiring all managers with investment discretion over $100 million in equity securities to report quarterly those holdings to the Commission on Form 13F.

Unfortunately there is no way directly to relate these turnover data to the holding period of any individual stock; therefore one cannot prove, from these data, that institutional investors take either short-term or long-term positions; although if one were to see a 400 percent turnover, this suggests considerable trading activity. Another problem in relating turnover to a short-term or long-term investment horizon is that the 13F filings may understate turnover, since they record only the net position at the end of the quarter, thus obscuring trading taken place during the quarter. Finally, turnover is measured only in equities and not in the more highly volatile derivative markets.

Indexation and New Instruments

Are pension funds better off if they invest in "passive" publicly traded common stock indexed funds with low transaction costs and arguably higher rates of return? This section examines the development of indexation by institutional investors. Some have advocated institutional investors adopt this passive approach to investing.[32] Others note that the development of a new variety of very sophisticated indexation techniques means indexation may not be as diametrically opposed to active management as some have argued, and that it is entirely possible for indexation to fit into an "active" management strategy.

Market factors in the development of indexes

By May 31, 1989, externally managed index funds had grown to $210.72 billion, up from approximately $50 billion in 1984. The largest index fund managers are: Wells Fargo (with $59.4 billion in total index funds, including domestic and international equity indexed instruments and domestic and international fixed income indexed instruments); Bankers Trust ($29.5 billion); Mellon Capital ($23.85 billion); State Street Bank ($21.1 billion); and ANB Investment ($9.4 billion). Exhibit 18 shows a survey by Pensions and Investments Age of the largest public and private pension funds with indexed portions of their equity portfolios as of September 20, 1988.

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[32] Robert Monks argues that active management of corporate pension funds' equity portfolios have, after transactions costs are accounted for, resulted in net lower returns than passively managed portfolios, and that establishing a requirement under ERISA that corporate pension funds generally hold publicly traded equities through indexed portfolios may result in higher rates of return for the funds, and may have a beneficial impact on corporate governance as well. See Testimony of Robert A.G. Monks, President, Institutional Shareholder Services, Inc. before the Subcommittee on Labor-Management Relations of the House Education and Labor Committee, February 9, 1989.

Among the factors which account for the substantial increase in indexes are:

- disaffection with the performance of active managers who are perceived as not being able to "beat the market";
- interest in reducing transaction costs which are substantially smaller, sometimes by a factor of 10, for index funds;
- perception that it is costly and self defeating to hire dozens of active managers to run large amounts of money because their results will tend to cancel each other out, resulting in a de facto indexation of the market;
- utilization of tactical asset allocation models which have also contributed to a synthetic securities market and indexation since they are frequently best effected through rapid market timing shifts in assets from equity indexes to bond indexes etc.[33]; and
- perception of the need to develop derivative instruments to hedge the underlying securities and to effect index arbitrage designed to counteract or capitalize on market swings.

Types of indexation instruments and passive derivative instruments

Pension funds began to invest in index funds approximately 20 years ago. In a "synthetic" market, this type of basket investing views stocks in a fungible and volatile manner, much the same way as commodities have characteristically been viewed. The trend to index a core of the fund's assets may, however, be accompanied by attempts to add value at the margin through active management. Also a variety of hybrid instruments have emerged which begin to approach active management by virtue of the very specific decisions which go into the compilation of these new tailored indexes.

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[33] Institutional Investor reports that slightly more than a handful of vendors offered tactical asset allocation models five years ago, however, today dozens of investment firms are either developing them or marketing them more aggressively. These include TSA Capital Management and the large index managers, Sanford C. Burnstein, Kemper Financial Services, J.P. Morgan and Chase Investors.

While Institutional Investor reported, in November 1988, that 86.2 percent of all domestic indexed equity assets were pegged to the Standard and Poor's 500 index, the survey also notes a proliferation of other indexes. Enhanced or index-plus funds are invested in derivative products intended to outperform their underlying indexes and 23.9 percent of all domestic and international index assets are reported to be devoted to these enhanced indexes.

The S&P 500, frequently referred to as the plain-vanilla variety of index, is one of the oldest indexes and a widely recognized barometer of the stock market as a whole.[34] Sub-indexes, also known as industry indexes are being developed to provide stock exchanges with additional ways to increase their market share in the stock index field as well as to satisfy portfolio managers looking for alternatives that produce more precise hedging vehicles.[35]

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[34] The S&P 500 Index is based on the stock prices of 500 different companies (400 industriales, 40 utilities, 20 transportation companies, and 40 financial institutions). Approximately 475 of the S&P 500 firms are presently listed on the New York Stock Exchange. The S&P 500 is a capitalization weighted index (capitalization refers to market capitalization, i.e., share price X shares outstanding), so that changes in the price of a particular stock will influence the index in proportion to the total market value of the outstanding stock of that particular company. The appropriate weight for a particular stock is determined by multiplying the number of its outstanding shares by its market price per share. For example IBM might account for approximately 5 percent of the S&P 500 Index while General Motors might account for approximately 2 percent. The S&P 500 Index is calculated using the base years 1941-1943 = 10. When the index is at 200, for example, total share prices of S&P 500 companies are 20 times what they were in the period 1941-1943.

An increasing number of variations on the basic indexes include the following:

- Simple tilts and biases (particularly the extended index fund and the yield tilt fund), which weight the index towards, for example, high yield equities;
- Small-cap (small-capitalization) funds pioneered by Dimensional Fund Advisors to target thinly traded, smaller companies;
- Indexed pools based on the Russell 2000 or the Wilshire 5000 indexes which have also become convenient vehicles for directing large pension funds into small capitalization stocks;
- Large and small-cap growth stocks and large and small-cap value stocks introduced by the Wilshire Group;
- Tailored or customized index funds which may be the next phase of highly specialized fund development including South Africa Free Funds, high technology funds, and specialized interests which can be built by a number of investment managers who are active in this field

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[35] For example, if a mutual fund or portfolio is heavily invested in computer stocks, trading based on an index tracking only computer stocks would be expected to produce a more precise hedge than would an offsetting position based on movements in the market as a whole. This is because an industry group as a whole can, for some period of time, diverge from movements of the broad market. Under criteria agreed to by the SEC and the CFTC, a sub-index would have to: (1) include 25 or more stocks; (2) have a total capitalization of at least $75 billion and be maintained at over $50 billion; and (3) have not a single stock that constitutes more than 25 percent of the weighted value of the index and no three stocks that together constitute more than 45 percent of the index value. These criteria are part of a regulatory accord between the SEC and the CFTC, under which stock indexes meeting these criteria are treated as futures subject to CFTC regulation whereas investments involving narrower bases may be treated as securities subject to SEC regulation.

including Alliance Capital Management and the Plexus Group;

- International fund indexes including indexes that trace the Financial Times-Actuaries or the Salomon-Russell primary market indexes as well as Europe, Australia and Far East indexes.[36] Also in the international area, Alliance Capital and Bankers Trust now offer index funds that weight stocks issued by companies in different countries by gross domestic product rather than by stock market capitalization, which lowers the exposure to Japan.

- The term core element appears to be replacing the term indexing in that the core will provide the central tendency of the return distribution. According to Fred Grauer, Chairman of Wells Fargo Investment Management, the country's biggest indexer, through indexing, he can provide the fund's target rate of return with a high degree of probability in a cost effective way. Then the active satellite manager can strive to produce the total fund's better than market return. Funds often "view passive vehicles in core positions as an argument for fairly heavy bet-taking in active areas," notes Ernest Bianco, senior vice president for the Frank Russell Company.[37]

It appears, therefore, that sophistication in index development is leading to a blend between indexation and active management. The next stage in the evolution of indexing is apparently a hybrid active-passive product. These will not be semi-passive funds, indexed with biases, but passive structures combined with active decision making based on traditional research and professional judgment. One approach used by Alliance Capital and Bankers Trust in the international area, for example, is to have their active managers allocate country weightings but then rely on passive stock selection within each country.[38]

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[36] Rowe Price-Fleming International, Wells Fargo Investment Management and State Street Bank and Trust Company recently launched international fixed-income index funds. Ronald Golz, Executive Vice President of State Street Bank, the leading international indexer (about $5 billion) is reported to have said, "we now have an index that will give you world returns. Five years from now you won't find anybody, except a handful of managers, who's not global." See: "Global Money Management," Institutional Investor, November 1988, p. 166.

[37] Id.

VI. INSTITUTIONAL INVESTOR INTERACTION WITH BOARDS

As institutional investors have increased their stake in U.S. corporations, tensions have mounted. Boards of directors and corporate management may be wary of institutions whom they view as "transient shareholders" and not "owners" in the historical sense -- especially because these institutional investors themselves represent at least plan beneficiaries and perhaps a broader group of stakeholders as well. But institutional fiduciaries argue they can legitimately claim to be "owners" since: they bear fiduciary responsibility for the funds under their charge; they did in fact make the investment in a particular company when there were multiple investments from which to choose; and many of them do hold for the long-term.

Certain economists such as Michael Jensen, who are steeped in the "efficient market" theory, argue it is not the function of stockholders to take permanent positions in corporations; the only stockholders who do so are management itself and perhaps labor. Rather, stockholders should act to provide incentive and discipline for management, especially in a liquid market where corporations are no longer closely held. Others, such as Professor Lowenstein note that markets may not be entirely efficient; that funds flowing to corporations come there less and less from the initial public offering market; and that the development of a "synthetic" market of derivative instruments also dilutes the original purpose of securities markets as providers of capital to corporations.

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[38] In a reverse pattern, BEA Associates is developing what its Vice President Douglas Love calls structured portfolios that will mimic an index's macro exposure -- industry and sector weightings and sensitivity to inflation, for instance -- but then use active management for security selection within a sector. This is not unlike the trend in fixed income management toward semi-passive programs that allow active managers to look for enhancement opportunities, but only with agreed upon parameters, so that the portfolios never stray far from the indexes in duration sensitivity and sector allocation. Id.

As institutional investors flex their muscles, two central questions arise: (1) what do institutional investors want from the corporation?; and (2) what interactions between shareholders and corporations are appropriate for shareholders to achieve their goals?

On the issue of institutional investor goals, some of the paradoxes referred to in the introduction leap to mind. If institutional investors are either indexed or "are the market" for stock, especially by virtue of their large asset strength and ability to command increasing percentages of a company's float, then they surely want long-term steady growth in appreciation of their stock price. Or, do they want a high short-term premium which they can take and reinvest elsewhere? The answer is: this depends on the profile of the institutional investor, the investment objectives, the risk parameters under which the fiduciary operates the portfolio, and any other special instructions from the board/trustee to the fiduciary.

But is it desirable, as a matter of economic growth, productivity, and our competitive position in the world economy for the institutional investor to be in the company for the long-term? Again: this depends on the company, the efficiency of its operations, its position within its industry, its plans for the future, etc.

This brings us to the "performance" controversy, and whether company performance (as measured by traditional securities analyst measures such as earnings per share and return on assets) is in any way related either to trading by institutional investors or to their voting patterns. The debate on this issue is, like others, colored by the "routine" versus the "change of corporate control" context in which investment/voting actions take place. Research is underway to attempt to determine whether there are such correlations, although early efforts have not proved conclusive.

More importantly, institutional shareholders have been awakened by the takeover wave, and even if that wave subsidizes or takes another channel, many believe that some form of institutional investor long-term monitoring of corporate governance issues will produce greater shareholder value. Furthermore, shareholders are more and more likely to undertake this monitoring, notwithstanding the DOL's mandate for fiduciaries to become involved in the proxy process. Indeed, recognizing the growing value of their vote, certain institutional shareholders have become extremely vocal about any perceived corporate moves to disenfranchise them (by the issuance, for example of unbundled stock units which would separate the vote).[39]

But what form should shareholder monitoring of corporations take? Institutional shareholders are clearly exploring many avenues for interaction with boards of directors. One option is to become involved quite specifically in the performance evaluation of companies in which they have substantial holdings. Some investment managers who track a limited number of stocks on a "fundamental" or "value" basis may well employ this strategy for all or part of any size portfolio under their management. A large institution, with an array of holdings, and a propensity internally to manage this portfolio might, however, find this prospect daunting.

Another approach taken by some institutional investors, sometimes in combination with other large shareholders,[40] is to press for direct board representation, so that there will be an "institutional investor seat" on the board. Some believe this approach will lead to fractionalizing and limiting the professionalism of boards, since each major constituent could then argue it should be in line for a seat. Others wonder what will be accomplished by this lone representative, since, even if that person were in place, many of the general issues of institutional oversight remain and may be only be obscured by what might be regarded as a temporary victory. Harrison J. Goldin and others would attest to the fact that such demands have certainly gotten the attention of management; although CEOs such as Bruce Atwater of General Mills would question whether this attention translates to better corporate performance.

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[39] The Securities and Exchange Commission effectively killed issuance of these unbundled stock units by maintaining that their units must be counted as shares of stock in determining earnings per share. There is still a controversy surrounding possible disenfranchisement stemming from the SEC's one-share one-vote rule issued last year.

[40] The potential for large institutional shareholders to act as a group raises its own series of public policy questions, consideration of which is, unfortunately, beyond the scope of the present effort.

A third approach, suggested by Millstein, is for shareholders to work with boards of directors on a variety of corporate governance matters. Thus, shareholders would work through various nominating committees, and audit committees to ensure that the corporation's board is functioning to the best of its ability and to the long-term benefit of the corporation and its shareholders. Shareholders will, of course, have to develop appropriate criteria to measure such "good" performance on the part of the board; criteria discussed by shareholders include a combination of objective measures, regarding such items as earnings per share, as well as corporate governance determinations, regarding such issues as: the presence of a majority of outside directors; the procedures of the board's audit committee and compensation committee; the elimination of poison pills or at least the provision for shareholder referenda if they are adopted; the institution of staggered boards; and similar corporate governance provisions.

VII. PUBLIC POLICY OPTIONS

Briefly, there are several major approaches to legislation concerning institutional shareholders.

Amend or Clarify ERISA

Many believe ERISA is too restrictive and that either legislation or regulatory clarification is necessary to permit fiduciaries a wider range of choice with respect to their investment decisions.[41] Thus, some would either amend ERISA or ask the Department of Labor to clarify it, to ensure that a fiduciary would not have violated its fiduciary responsibility upon consideration of the long-term benefits of plan participants and beneficiaries. As this report indicates, the Departments of Labor and Treasury have clarified the tender offer premium issue, but some believe their statement did not go far enough in detailing the range of considerations which should be allowed to be included in a fiduciary's decision.

Institutional Investors and Proxy Voting

Several legislative proposals involve the proxy voting process. Among them is the proposal to provide shareholders holding above a certain percentage of a company's outstanding stock with access to the corporation's proxy statement, and any supplemental statements made to shareholders regarding such issues as the election of directors.[42] Where descriptions and statements are required, these shareholders would have to receive equal space, and coverage. Legislation would require an amendment to Section 14(a) of the Securities and Exchange Act of 1934, but would be subject to Commission rules with respect to eligibility, timing, and the resolution of disputes between proponents of materials and issuers.

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[41] In the 100th Congress, S. 1323 would have amended ERISA. The Governor's Task Force advocates clarification of ERISA rather than its amendment.

Another proposal involves secret balloting of proxy materials, with a certified third party to administer the proxy voting process.[43] This legislation is prompted by concern that fiduciaries, especially in the private pension fund area, and certain designated money managers, are being discouraged from casting their proxies in the event they wish to vote against managements who would either prevent them or censure them for doing so.

Differential Capital Gains on Short-Term Trading

Legislation has been introduced[44] to place a 10 percent capital gains tax on gains from pension fund assets held less than 30 days, and a 5 percent tax in the case of any gain from assets held for longer than 30 days but not longer than 180 days. Certain exceptions are provided for "hedging" transactions.

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[42] Section 8, S. 1244, (Metzenbaum, Armstrong), June 22, 1989. This bill provides for shareholder access if such shareholder or group is the beneficial owner of voting equity securities not less than three percent of the voting power of the issuers' securities. Other proposals have set the threshold at different percentages, e.g. at 10 percent (S. 1323, Proxmire, et.al. in the 100th Congress).

[43] Section 7, S. 1244, (Metzenbaum, Armstrong), June 22, 1989.

[44] S. 1654, (Kassebaum, Dole), September 21, 1989.

Public policy makers may wish to evaluate these and other legislative approaches keeping in mind three key issues raised in this report: (1) there is a diverse universe of institutional investors, with varying investment/corporate governance strategies and organizational structures for implementing these strategies; (2) investment and corporate governance decisions may be quite different for "routine" investment and governance matters than they are during contests for corporate control, although the differences have precipitated a level of shareholder involvement not likely to diminish even if contests for corporate control diminish; and (3) the increased concentration of economic power these institutions have also increases the likelihood that changes in their investment and corporate governance patterns will profoundly affect the capital formation process in our financial ecosystem.

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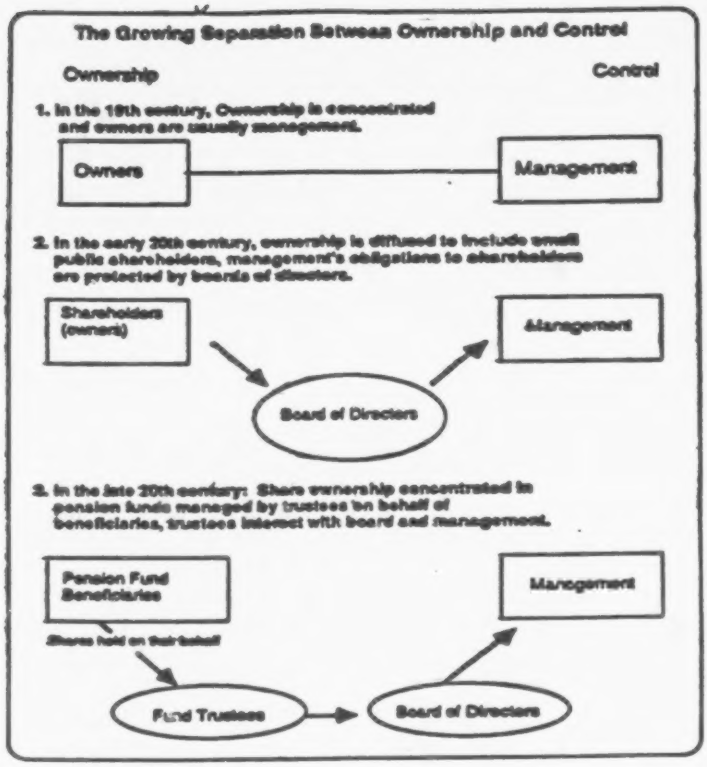
Exhibit 1



The Growing Separation Between Ownership and Control

1. In the 19th century, Ownership is concentrated and owners are usually management.

2. In the early 20th century, ownership is diffused to include small public shareholders, management's obligations to shareholders are protected by boards of directors.

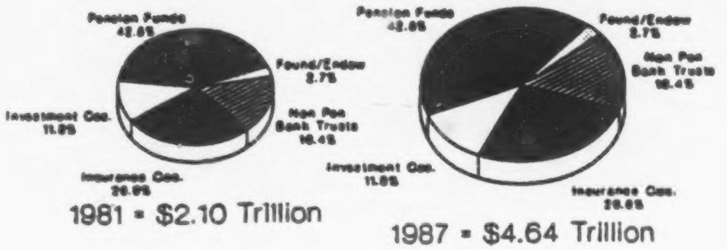
3. In the late 20th century: Share ownership concentrated in pension funds managed by trustees on behalf of beneficiaries, trustees interact with board and management.

Ownership
Control
Owners
Management
Shareholders (owners)
Management
Board of Directors
Pension Fund Beneficiaries
Shares held on their behalf
Management
Fund Trustees
Board of Directors

Source: The Report of the Governor's Task Force on Pension Fund Investment. Our Money's Worth. Governor Mario M. Cuomo, Chairman Ira M. Millstein and Director Lee Smith. June 1989. p.3.

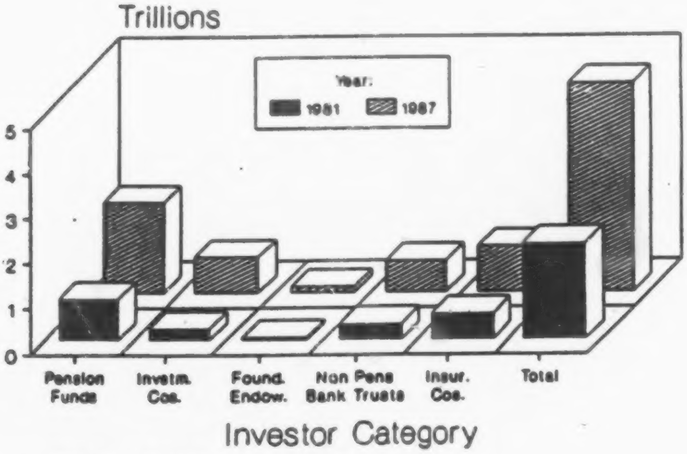
Exhibit 2

TOTAL ASSETS - INSTITUTIONAL INVESTORS



Source: Columbia Data Collection Project

TOTAL ASSETS - INSTITUTIONAL INVESTORS



Source: Columbia Data Collection Project

Exhibit 3

Institutional Investors
Growth in Assets by Category: 1981 - 1987
(billions of dollars)

	1981	Percent of Total Assets	1987	Percent of Total Assets	Annual Growth 1981-1987
Pension Funds					
Private Trusteed	$ 486.7	23.2%	$1,037.4	22.3%	13.4%
Private Insured	180.3	8.6%	406.0	9.9%	16.9%
State/Local Gov't	224.2	10.7%	521.4	11.2%	15.9%
Subtotal (a)	891.2	42.5%	2,018.8	43.5%	14.6%
Investment Companies					
Open End/Mutual Funds	241.4	11.5%	769.9	16.6%	21.3%
Closed End/Invest Trusts	6.9	0.3%	20.5	0.4%	19.9%
Subtotal	248.3	11.8%	790.4	17.0%	21.3%
Insurance Companies					
Life Insurance (b)	347.0	16.5%	584.5	12.6%	9.1%
Property/Casualty	212.0	10.1%	426.7	9.2%	12.4%
Subtotal	559.0	26.6%	1,011.2	21.8%	10.4%
Banks Trusts					
Non Pension Bank Trusts (c)	344.9	16.4%	693.4	14.9%	12.3%
Foundations/Endowments	56.0	2.7%	130.6	2.8%	15.2%
All Institutions					
Total	$2,099.4	100.0%	$4,644.4	100.0%	14.1%

Notes:

(a) The Employee Benefit Research Institute notes that its data may contain a number of discrepancies in aggregating totals.

(b) Total Life Insurance Assets = $525.8 billion in 1981 and $937.6 billion in 1986, but an estimated one-third of these are listed in pension fund category since life insurance companies manage about one-third of all pension fund assets.

(c) The pension assets that are trusted to banks have been already included in the private trusteed pension funds. Therefore, these assets are not included in the table.

Source: Brancato, Carolyn Kay and Patrick A. Gaughan. The Growth of Institutional Investors in U.S. Capital Markets. Institutional Investor Project. Columbia Center for Law and Economic Studies. November, 1988. p.7.

Exhibit 4
p.1

Institutional Investors - Total Assets and Percent of Equity Markets
1981 - 1986
(billions of dollars)

	1981			
	1981 Assets	Percent Equity Allocation	$ Equity	Percent of Total Market Value of Equities(d)
Pension Funds				
Private Trusteed	$486.7	45.9%	$223.4	14.5%
Private Insured	180.3	8.7%	15.7	1.0%
State/Local Gov't.	224.2	21.0%	47.1	3.1%
Subtotal (a)	891.2	32.0%	285.2	18.5%
Investment Companies				
Open End/Mutual Funds	241.4	16.0%	38.6	2.5%
Closed End/Invest Trusts	6.9	n.a.	-	-
Subtotal	248.3	-	-	-
Insurance Companies				
Life Insurance (b)	347.0	9.1%	47.7	3.1%
Property/Casualty	212.0	18.7%	39.6	2.6%
Subtotal	559.0	15.6%	87.3	5.7%
Bank Trusts				
Non Pension Bank Trusts (c)	344.9	45.0%(est)	155.2	10.1%
Foundations/Endowments	56.0	50.0%(est)	28.0	1.8%
Total-All Institutions	$2,099.4		$594.3	38.5%

Exhibit 4
p.2

	1986			
	1986 Assets	Percent Equity Allocation	$ Equity	Percent of Total Market Value of Equities(d)
Pension Funds				
Private Trusteed	$938.5	48.6%	$456.1	14.7%
Private Insured	406.5	9.1%	37.0	1.2%
State/Local Gov't.	469.5	32.0%	150.2	4.8%
Subtotal (a)	1,814.5	35.0%	635.1	20.4%
Investment Companies				
Open End/Mutual Funds	716.5	28.0%	200.6	6.5%
Closed End/Invest Trusts	10.7	n.a.	-	-
Subtotal	727.0	-	-	-
Insurance Companies				
Life Insurance (b)	618.8	9.7%	60.0	1.9%
Property/Casualty	374.0	21.7%	81.0	2.6%
Subtotal	992.0	14.2%	141.0	4.5%
Bank Trusts				
Non Pension Bank Trusts (c)	614.6	47.7%(est)	293.0	9.4%
Foundations/Endowments	114.9	50.0%(est)	57.5	1.8%
Total-All Institutions	$4,263.0		$1,327.2	42.7%

Notes:

a) The Employee Benefit Research Institute notes that its data may contain a number of discrepancies in aggregating totals.

b) Total Life Insurance Assets = $525.8 billion in 1981 and $937.6 billion in 1986, but an estimated one-third of these are listed in pension fund category since life insurance companies manage about one third of all pension fund assets.

c) Bank Pension Trusts are not included in this table since they have been already included in private trusteed pension funds. They amounted to $250.9 billion in 1981 and 450.7 billion in 1986.

d) Estimated from Federal Reserve Data, adding back mutual fund shares. Total equity at year end was $1,542 billion for 1981 and $3,109.2 billion for 1986. Total may not add exactly due to rounding.

Source: Brancato, Carolyn Kay and Patrick A. Gaughan. The Growth of Institutional Investors in U.S. Capital Markets. Institutional Investor Project. Columbia Center for Law and Economic Studies. November, 1988. p.13.

Exhibit 5

Institutional Ownership of Top 50 Corporations

COMPANY	1988 RANK*	INSTITUTIONAL HOLDINGS (%)		ARE INSTITUTIONAL HOLDING IN 1988 GREATER THAN		
		1987	1988	33%?	40%?	50%?
IBM	1	50	49	YES	YES	
EXXON	2	35	34	YES		
GENRAL ELECTRIC	3	51	47	YES	YES	
AT&T	4	18	23			
PHILIP MORRIS	5	60	64	YES	YES	YES
GENERAL MOTORS	6	40	82	YES	YES	YES
MERCK	7	64	55	YES	YES	YES
FORD MOTOR	8	63	55	YES	YES	YES
DU PONT	9	40	40	YES		
AMOCO	10	40	86	YES	YES	YES
MOBIL	11	41	74	YES	YES	YES
RJR NABISCO	12	42	45	YES	YES	
BELLSOUTH	13	28	26			
CHEVRON	14	39	39	YES		
WAL-MART STORES	15	36	31			
COCA-COLA	16	52	53	YES	YES	YES
DOW CHEMICAL	17	51	51	YES	YES	YES
SEARS, ROEBUCK	18	51	51	YES	YES	YES
ATLANTIC RICHFIELD	19	52	54	YES	YES	YES
MINNESOTA MINING & MFG.	20	63	64	YES	YES	YES
PROCTER & GAMBLE	21	48	52	YES	YES	YES
JOHNSON & JOHNSON	22	66	63	YES	YES	YES
GTE	23	52	55	YES	YES	YES
EASTMAN KODAK	24	52	50	YES	YES	YES
BELL ATLANTIC	25	32	33	YES		
PACIFIC TELESIS GROUP	26	44	43	YES		
ELI LILLY	27	69	71	YES	YES	YES
AMERITECH	28	35	33	YES		
NYNEX	29	34	34	YES		
BRISTOL-MYERS	30	56	56	YES	YES	YES
SOUTHWESTERN BELL	31	41	40	YES		
DIGITAL EQUIPMENT	32	81	69	YES	YES	YES
TEXACO	33	36	42	YES		
AMERICAN INT'L GP	34	46	48	YES	YES	
AMERICAN EXPRESS	35	63	61	YES	YES	YES
HEWLETT-PACKARD	36	49	47	YES	YES	
AMERICAN HOME PROD.	37	55	59	YES	YES	YES
ABBOT LABORATORIES	38	48	52	YES	YES	YES
PEPSICO	39	49	55	YES	YES	YES
US WEST	40	40	38	YES		
BOEING	41	52	61	YES	YES	YES
WALT DISNEY	42	35	43	YES	YES	
WASTE MANAGEMENT	43	67	58	YES	YES	YES
ANHEUSER-BUSCH	44	55	53	YES	YES	YES
MCDONALD'S	45	58	58	YES	YES	YES
PFIZER	46	57	61	YES	YES	YES
CITICORP	47	73	70	YES	YES	YES
DUN & BRADSTREET	48	68	63	YES	YES	YES
SCHLUMBERGER	49	42	49	YES	YES	
USX	50	38	54	YES	YES	YES
AVERAGE		49	52	47	37	30

*Ranked by Stock Market Value

Source: Compiled from Business Week's Database on Top 1000 Corporations Ranked by Stock Market Value

Exhibit 6

Institutional Investor Ownership in U.S. Corporations 1987-1988

Companies Ranked By Stock Market Value	Institutional Holdings As % Outstanding Stock	
	1987	1988
Top 1-50 Companies	48.7	51.6
Top 51-100 Companies	58.6	55.7
Top 101-250 Companies	52.3	52.4
Top 251-500 Companies	50.7	49.7
Top 501-750 Companies	45.2	43.8
Top 751-1000 Companies	37.7	40.8
Cumulative Averages	1987	1988
Top 50 Companies	48.7	51.6
Top 100 Companies	53.6	53.4
Top 250 Companies	52.8	52.8
Top 500 Companies	51.8	51.2
Top 750 Companies	49.6	48.8
Top 1000 Companies	46.6	46.8

Source: Complied from Business Week's Database on Top 1000 Corporations Ranked by Stock Market Value.

Exhibit 7

Institutional Investor
Holdings in U.S. Corporations
Average % Holdings
By Industry Grouping
1987-1988

Industry Group	Average Institutional Holdings As % Outstanding Stock	
	1987	1988
Aerospace	54.6	58.0
Automotive	53.8	52.1
Banks	39.6	41.5
Chemicals	55.7	55.2
Conglomerate	42.6	50.3
Consumer	48.8	49.0
Containers	46.1	41.0
Electrical	58.6	59.0
Food	43.8	42.0
Fuel	46.5	47.0
Health Care	50.0	52.0
Housing	41.4	36.0
Leisure	43.4	44.0
Manufacturing	53.2	53.0
Metals	46.5	43.0
Nonbank Financing	50.9	54.0
Office Equipment	53.0	54.0
Paper	55.7	58.0
Publishing/TV	44.5	39.0
Retailing	45.1	43.0
Services	45.0	48.0
Telecommunications	36.6	35.0
Transportation	54.9	58.0
Utilities	34.5	35.0
Average - All Corporations in Top 1000 Group	46.6	46.8

Source: Complied from Business Week's Database on Top 1000 Corporations Ranked by Stock Market Value.

Exhibit 8

Pension Fund Financial Asset Structure
And Rate of Growth: 1946-1988

Period	Financial Assets at End of Period Private Trusteed	 Private Insured	 State and Local	Avg. Annual Growth During Period Private Trusteed	 Private Insured	 State and Local
		(billions)				
1946-1950	$ 7.1	$ 5.6	$ 4.9	17.9%	n.a.	13.3%
1951-1955	18.3	11.3	10.8	21.1	15.1	17.4
1956-1960	38.1	18.9	19.7	15.8	10.7	12.7
1961-1965	74.4	27.4	34.1	14.3	7.7	11.5
1966-1970	112.0	40.8	60.3	8.5	8.3	12.1
1971-1975	225.0	70.1	104.8	15.0	11.4	11.7
1976	251.9	85.8	120.4	11.9	22.5	14.9
1977	271.7	97.5	132.5	7.9	13.5	10.1
1978	326.2	114.1	153.9	20.1	17.1	16.1
1979	386.1	132.5	169.7	18.4	16.1	10.3
1980	469.6	157.2	198.1	21.6	18.7	16.7
1981	486.7	180.3	224.2	3.7	14.6	13.2
1982	575.8	211.3	262.5	18.3	17.2	17.1
1983	682.4	246.4	311.2	18.5	16.6	18.5
1984	713.9	286.4	356.6	4.6	16.2	14.6
1985	848.1	343.8	404.7	18.8	19.9	13.5
1986	941.9	406.6	469.4	11.1	18.4	16.0
1987	1,000.8	459.8	520.0	6.3	13.1	10.8
1988	1,123.2	n.a.	608.6	12.2	n.a.	17.0

Source: EBRI Quarterly Pension Investment Report, 1st Quarter 1989, p.48.

Exhibit 9

Pension Fund Holdings of Selected Financial Assets: 1950-1988

	Percent Distribution of Financial Assets by Fund Type				Pension Fund Asset Type Holdings as a Percent of Total Financial Assets of Asset Type in the Economy		
Year	Private Trusteed	Private Insured	State and Local	All Funds	Equity	Taxable Bonds	Cash Items
1950	40.3%	32.0%	27.7%	100.0%	0.8%	3.2%	0.2%
1955	45.3	28.0	26.7	100.0	2.0	6.2	0.2
1960	49.7	24.6	25.7	100.0	4.0	9.4	0.2
1965	54.8	20.1	25.1	100.0	6.1	12.8	0.2
1970	52.6	19.1	28.3	100.0	9.4	13.7	0.3
1975	56.3	17.5	26.2	100.0	16.6	15.0	1.8
1976	55.0	18.7	26.3	100.0	16.6	14.4	1.8
1977	54.2	19.4	26.4	100.0	17.2	15.0	1.9
1978	54.9	19.2	25.9	100.0	19.8	15.8	2.2
1979	56.1	19.2	24.7	100.0	19.0	16.6	2.6
1980	56.9	19.1	24.0	100.0	18.1	18.1	2.5
1981	54.6	20.2	25.2	100.0	18.7	19.2	2.6
1982	54.9	20.1	25.0	100.0	19.8	19.0	3.1
1983	55.0	19.9	25.1	100.0	21.1	18.4	3.4
1984	52.6	21.1	26.3	100.0	21.1	17.8	3.4
1985	53.1	21.5	25.4	100.0	21.0	16.7	3.7
1986	51.8	22.4	25.8	100.0	21.8	15.4	3.8
1987	50.5	23.2	26.3	100.0	23.6	15.0	4.5
1988	n.a	n.a	n.a.	n.a.	24.6	15.3	5.3

Source: EBRI Quaterly Pension Investment Report, 1st Quarter 1989, p. 55.

Exhibit 10

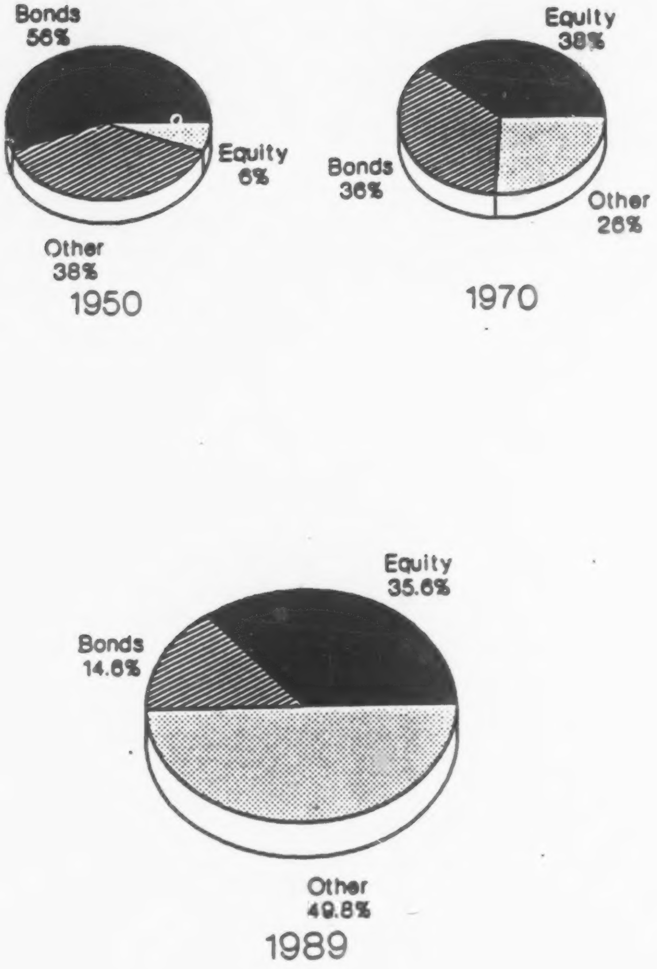
Pension Fund Holdings of Equities: 1950 - 1988

	Equity Holdings by Pension Plan Type				Pension Fund Equity Holdings as a Percent of Total Equity Assets in the Economy		
Year	Private Trusteed	Private Insured ($billions)	State and Local	All Funds	Private Trusteed	Private Insured	State and Local
1950	$ 1.1	$	$ 0.0	$ 1.1	0.8%	n.a.	0.0%
1955	6.1	n.a.	0.2	6.3	2.0	n.a.	0.1
1960	16.5	n.a.	0.6	17.1	3.8	n.a.	0.1
1965	40.8	n.a.	2.5	43.3	5.7	n.a.	0.4
1970	67.1	3.8	10.1	81.0	7.3	0.4	1.2
1975	108.0	8.7	24.3	141.0	12.7	1.0	2.9
1976	125.5	11.5	30.1	167.1	12.5	1.1	3.0
1977	123.6	10.2	30.0	163.9	13.0	1.1	3.2
1978	150.3	10.7	33.3	194.3	15.3	1.1	3.4
1979	175.4	11.9	37.1	224.5	14.9	1.0	3.1
1980	223.5	16.3	44.3	284.1	14.2	1.0	2.8
1981	218.5	15.7	47.8	282.0	14.5	1.0	3.2
1982	261.9	19.2	60.2	341.3	15.2	1.1	3.5
1983	313.6	23.5	89.6	426.7	15.5	1.2	4.4
1984	308.7	21.5	96.5	426.7	15.3	1.1	4.8
1985	393.3	30.2	120.1	543.5	15.2	1.2	4.6
1986	456.4	37.0	150.2	643.6	15.5	1.3	5.1
1987	460.6	41.5	172.6	674.7	16.1	1.5	6.0
1988	506.9	41.5	219.3	767.7	16.3	1.3	7.0

Source: EBRI Quarterly Pension Investment Report, 1st Quarter 1989, p. 57

Exhibit 11

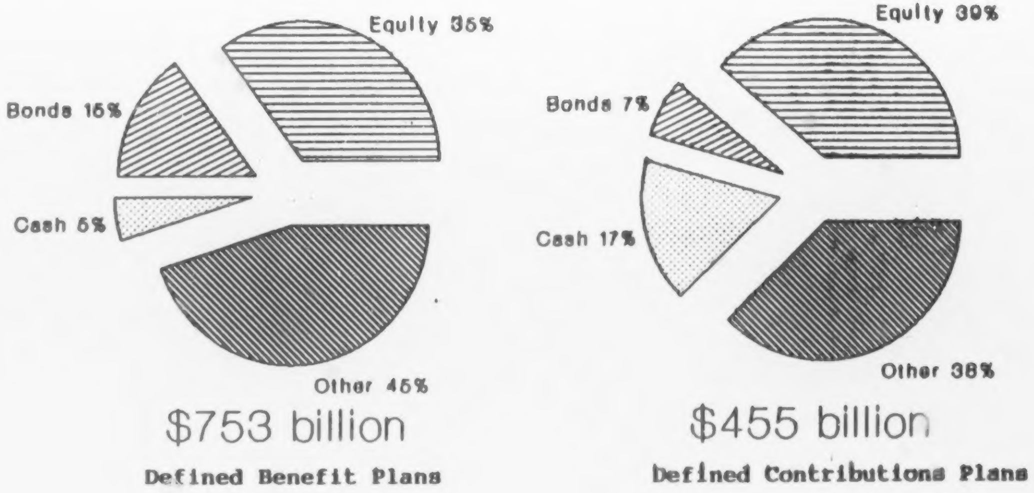
Asset Structure of All Pension Funds



Source: Employee Benefit Research Inst.

Exhibit 12

Private Trusteed Pension Assets as of March 31, 1989, by Asset Distribution



Source: EBRI

Exhibit 13
p. 1

Status of Pension Fund Obligations for the Top 100 Corporations With Largest Defined Benefit Plans

	Accum. Benefit Obligation (ABO)	Projected Benefited Obligation (PBO)	Plan Assets	Plan Assets in excess of PBO	Actual Return on plan assets	Net periodic pension expense (income)	Pension expense as a % of adjusted net income	Plan assets as a % of corporate assets	ABO as a % of shareholders equity
Aenta	905.5	1,378.0	1,551.0	173.0	124.4	3.6	0.5	1.9	13.9
Alco OP	2,466.5	2,595.2	2,557.1	-38.1	228.0	68.3	7.3	34.3	83.2
Alcoa UP	19.2	21.1	0.2	-20.9	n.a.	n.a.	n.a.	n.a.	n.a.
Allied-Signal OP	2,794.0	3,163.0	3,571.0	408.0	565.0	61.0	11.6	35.7	85.5
Allied-Signal UP	602.0	615.0	570.0	-45.0	n.a.	n.a.	n.a.	n.a.	n.a.
American Brands OP	565.6	713.9	934.1	220.1	11.3	19.6	3.3	7.6	22.7
American Brands UP	389.1	426.5	369.0	-57.5	n.a.	n.a.	n.a.	n.a.	n.a.
American Cyanamid	982.5	1,109.8	1,096.7	13.1	115.4	30.0	8.9	23.9	47.6
American Electric	720.2	902.2	1,075.7	173.5	129.2	(0.7)	n.m.	7.5	17.0
Ameritech	6,460.3	7,194.7	10,766.1	3,571.4	1,273.1	54.2	4.2	56.2	82.4
Amoco	1,692.0	2,049.0	2,500.0	451.0	304.0	7.0	0.3	8.4	12.7
AMR	1,611.0	1,938.4	1,701.5	-236.9	-210.5	62.1	11.5	17.5	48.8
Armco	1,761.0	1,913.4	1,589.0	-324.4	-175.4	66.6	31.4	57.0	197.8
Atlan. Richfield OP	1,243.0	1,392.0	2,152.0	760.0	180.0	(6.0)	n.m.	10.0	19.9
Atlan. Richfield UP	172.0	178.0	-	-178.0	-	-	-	-	-
AT&T	16,972.0	18,157.0	28,462.0	10,305.0	3,363.0	(363.0)	n.m.	81.0	148.0
Batus OP	810.3	1,043.8	1,277.7	233.8	131.9	12.5	2.3	11.1	35.9
Batus UP	49.0	58.3	17.1	-41.2	-	-	-	-	-
Bell Atlantic	7,018.6	8,197.1	9,669.5	1,472.0	1,191.3	165.8	11.2	39.1	76.5
BellSouth	6,800.2	8,319.6	9,136.9	817.3	1,110.8	137.2	7.7	32.1	57.4
Bethlehem Steel	3,833.2	3,968.7	1,628.6	-1,156.8	270.4	185.8	31.6	36.6	214.0
Boeing	4,310.0	5,246.0	5,638.0	392.0	454.0	173.0	22.0	44.7	79.8
Caterpillar OP	1,677.0	2,001.0	2,502.0	501.0	982.0	6.0	1.0	60.8	40.8
Caterpillar UP	1,504.0	1,517.0	1,335.0	-182.0	-	-	-	-	-
Champion Int'l	848.7	944.6	965.0	20.0	109.7	16.6	3.8	14.4	2.9
Chevron OP	2,588.0	2,963.0	3,756.0	793.0	395.0	74.0	4.0	11.1	17.8
Chevron UP	103.0	113.0	1.0	-112.0	-	-	-	-	-
Chrysler	7,328.3	7,405.9	4,358.3	-3,047.6	363.2	885.3	38.8	9.0	96.7
CIGNA	714.9	1,018.9	1,047.2	28.3	93.9	30.0	6.0	1.9	13.6
Commonwealth Ed.	1,357.0	1,676.0	1,879.0	203.0	200.0	12.0	1.6	10.5	17.1

	Accum. Benefit Obligation (ABO)	Projected Benefited Obligation (PBO)	Plan Assets	Plan Assets in excess of PBO	Actual Return on plan assets	Net periodic pension expense (income)	Pension expense as a % of adjusted net income	Plan assets as a % of corporate assets	ABO as a % of shareholders equity
Deere OP	924.0	1,192.0	1,284.0	92.0	8.0	18.0	5.4	24.5	37.6
Deere UP	1,022.0	1,077.0	899.0	-178.0	-	-	-	-	-
Delta Air Lines	2,117.5	3,065.4	2,704.7	-360.6	18.1	120.9	28.3	47.1	95.9
Digital	448.9	1,375.9	1,592.0	216.1	590.0	126.4	8.8	157.4	6.0
Dow Chemical	1,881.0	2,272.0	2,267.0	5.0	257.0	72.0	2.9	14.0	25.9
DuPont	6,740.0	7,772.0	12,333.0	4,561.0	1,378.0	(485.0)	n.m.	40.1	43.3
Eastern Airlines	1,566.5	1,632.2	1,218.0	-414.1	149.5	90.9	16.4	33.2	n.m.
Eastman Kodak	3,662.0	4,656.0	6,102.0	1,446.0	893.0	(130.0)	n.m.	26.6	84.0
Eaton OP	710.4	801.0	943.5	142.5	178.0	9.8	4.4	31.1	61.3
Eaton UP	131.7	142.2	68.2	-74.0	-	-	-	-	-
Exxon	3,111.0	3,541.0	4,764.0	1,223.0	880.0	(105.0)	n.m.	6.4	9.8
Ford OP	6,383.8	7,191.4	9,340.3	2,148.9	1,666.0	403.7	7.1	8.8	19.8
Ford UP	6,648.4	6,724.6	6,082.5	-642.1	-	-	-	-	-
FPL Group	471.7	495.2	1,213.8	718.6	168.3	(2.3)	n.m.	10.3	14.4
GenCorp	1,231.0	1,255.0	1,380.0	125.0	139.0	9.0	11.4	112.2	n.m.
Gen. Dynamics OP	2,451.4	2,766.8	3,259.3	429.5	379.8	70.0	15.6	89.6	127.5
Gen. Dynamics UP	128.0	128.0	106.0	-22.0	-	-	-	-	-
General Electric	14,073.0	15,473.0	21,502.0	6,029.0	2,261.0	(287.0)	n.m.	19.4	76.2
G.M. OP	13,611.9	15,112.0	1,932.4	3,820.4	56.1	517.7	9.6	1.2	38.2
G.M. UP	19,604.0	19,673.9	17,477.9	-2,196.0	-	-	-	-	-
Gen. Public Util.	637.8	843.2	885.4	42.2	105.2	35.3	11.1	13.8	31.5
GM Hughes	2,081.6	2,547.6	3,792.3	1,244.7	436.8	(76.5)	n.m.	32.1	27.6
Goodyear OP	132.1	156.1	156.6	0.5	157.9	51.7	12.9	1.8	6.5
Goodyear UP	1,038.6	1,131.0	864.9	-266.1	-	-	-	-	-
Grumman	1,430.7	1,655.3	1,934.9	279.6	160.8	23.8	21.6	75.4	174.0
GTE	3,900.0	5,781.0	9,074.0	3,293.0	1,300.9	(26.2)	n.m.	29.2	41.1
John Hancock	426.4	648.0	743.0	95.0	-	22.3	11.5	2.5	39.0
Hercules	692.0	787.4	1,124.9	337.5	124.2	(27.5)	n.m.	33.8	33.8
Honeywell OP	1,314.7	1,481.4	1,550.9	69.5	88.5	40.6	-10.3	30.5	75.9
Honeywell UP	396.3	400.9	310.4	-90.5	-	-	-	-	-
IBM	10,473.0	15,466.0	19,598.0	4,132.0	2,058.0	(55.0)	n.m.	26.8	26.8
Inland Steel	1,127.0	1,233.0	1,488.0	255.0	167.0	(21.0)	n.m.	50.9	72.3
Int'l Paper	1,193.0	1,302.0	1,996.0	694.0	103.0	(58.0)	n.m.	30.7	26.2
ITT	1,676.0	1,975.0	1,926.0	-49.0	245.0	146.0	15.2	4.6	20.9

Exhibit 13
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	Accum. Benefit Obligation (ABO)	Projected Benefited Obligation (PBO)	Plan Assets	Plan Assets in excess of PBO	Actual Return on plan assets	Net periodic pension expense (income)	Pension expense as a % of adjusted net income	Plan assets as a % of corporate assets	ABO as a % of shareholders equity
James River OP	564.4	564.7	596.0	31.3	11.4	14.6	6.5	11.9	30.1
James River UP	382.9	412.4	313.3	-99.1	-	-	-	-	-
Johnson & Johnson	681.0	878.0	1,022.0	144.0	123.0	33.0	3.3	14.4	19.4
K mart	694.0	871.0	986.0	115.0	126.0	25.0	3.0	8.1	13.9
Eli Lilly	823.9	1,092.4	1,315.8	223.4	183.7	20.2	2.6	25.0	25.5
Litton	549.1	627.3	913.6	286.3	359.0	10.0	5.6	18.0	46.7
Lockheed	3,097.0	3,538.0	4,981.0	1,443.0	541.0	7.0	1.1	75.0	125.1
Martin Marietta	1,051.3	1,334.0	1,987.8	653.8	132.8	39.7	10.0	59.9	87.6
McDonnell Douglas	2,911.0	3,334.0	5,099.0	1,765.0	770.0	(93.0)	n.m.	42.9	91.4
Metropolitan Life	866.0	-	1,448.0	-	-	-	0.0	1.5	24.9
Minnesota Mining	1,525.0	1,753.0	2,173.0	420.0	217.0	0.0	0.0	24.4	27.7
Mobil	1,717.0	2,194.0	2,224.0	30.0	228.0	50.0	1.8	5.7	10.9
Monsanto	2,312.0	2,640.0	3,169.0	529.0	340.0	4.0	0.7	37.5	60.8
Navistar OP	25.0	27.0	60.0	33.0	230.0	83.0	25.4	2.4	2.9
Navistar UP	2,126.0	2,158.0	1,751.0	-407.0	-	-	-	-	-
NCR OP	698.5	815.8	1,161.9	346.1	134.0	(6.7)	n.m.	24.6	31.2
NCR UP	20.5	26.2	0.1	-26.1	-	-	-	-	-
Nor. Amer. Phillips	607.3	748.2	1,025.0	276.8	138.6	(10.7)	n.m.	29.9	38.4
Northrup OP	1,269.1	1,566.3	2,263.3	697.0	223.0	4.3	4.0	72.1	126.5
Northrup UP	32.9	37.6	8.0	-29.6	-	-	-	-	-
NWA OP	553.4	741.7	822.2	80.6	117.5	28.1	17.2	18.8	33.9
NWA UP	359.3	366.9	316.3	-50.6	-	-	-	-	-
NYNEX	7,722.0	9,267.0	11,539.0	2,272.0	1,488.0	31.0	2.3	45.5	82.8
Pacific Telesis	6,089.0	7,159.0	8,898.0	1,739.0	1,147.0	130.0	9.9	42.0	75.3
JC Penney	758.0	1,001.0	1,164.0	163.0	125.0	(5.0)	n.m.	9.5	19.2
PG&E	1,931.7	2,721.0	2,535.7	185.3	323.1	103.5	62.5	12.0	28.0
Phil. Electric	747.7	1,046.7	1,163.1	116.4	134.6	7.1	1.2	9.8	20.8
Philip Morris	3,709.0	3,507.0	4,353.0	846.0	372.0	26.0	1.1	11.8	35.3
PPG OP	179.3	187.0	245.4	58.4	112.1	(4.0)	n.m.	4.8	8.0
PPG UP	663.1	812.6	775.1	37.5	-	-	-	-	-
Prudential	2,125.0	2,814.0	4,159.0	1,345.0	61.0	129.0	13.5	2.7	56.4

Exhibit 13
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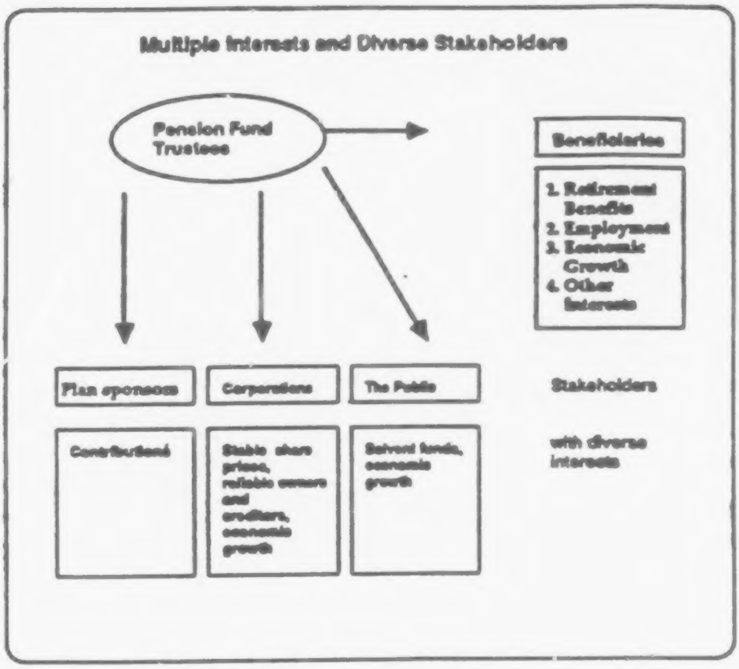
	Accum. Benefit Obligation (ABO)	Projected Benefited Obligation (PBO)	Plan Assets	Plan Assets in excess of PBO	Actual Return on plan assets	Net periodic pension expense (income)	Pension expense as a % of adjusted net income	Plan assets as a % of corporate assets	ABO as a % of shareholders equity
Raytheon OP	1,010.0	1,342.9	1,564.1	221.2	258.7	58.4	10.7	33.0	47.7
Raytheon UP	429.0	431.6	403.8	-27.8	-	-	-	-	-
Rockwell Int'l OP	3,971.4	4,511.7	5,776.7	1,265.0	851.0	(135.9)	n.m.	62.7	107.5
Rockwell Int'l UP	615.1	639.4	445.7	-193.7	-	-	-	-	-
Sears, Roebuck OP	3,912.0	3,793.0	4,621.0	828.0	523.0	72.9	4.8	5.9	20.7
Sears, Roebuck UP	213.0	269.0	181.0	-88.0	-	-	-	-	-
Shell Oil	2,364.0	2,701.0	3,173.0	472.0	388.0	47.0	3.7	11.7	18.4
SoCal Edison	973.7	1,409.1	1,326.6	-82.4	133.7	46.1	5.7	8.9	19.2
Southern Co.	930.0	1,377.0	1,976.0	599.0	223.0	38.0	4.3	10.0	13.9
So. New England Tel.	861.8	983.1	1,426.8	443.7	194.2	(9.3)	n.m.	46.5	74.6
Southwestern Bell	3,893.0	3,930.9	6,189.3	2,258.4	718.7	56.0	5.0	29.5	45.8
Sun Oil OP	882.0	1,009.0	1,178.0	169.0	175.0	(8.0)	n.m.	13.7	26.5
Sun Oil UP	151.0	164.0	54.0	-110.0	-	-	-	-	-
Toledyne	666.1	791.1	1,425.7	634.6	99.3	(34.7)	n.m.	45.0	31.1
Tenneco OP	1,263.0	1,536.0	2,221.0	685.0	-163.0	(57.0)	n.m.	12.8	40.8
Tenneco UP	316.0	318.0	200.0	-118.0	-	-	-	-	-
Texaco	964.0	1,281.0	1,323.0	42.0	153.0	46.0	3.4	8.0	11.9
Textron OP	1,350.5	1,557.3	2,059.4	502.1	210.3	8.4	2.3	16.4	56.6
Textron UP	241.7	249.3	170.1	79.2	-	-	-	-	-
Travelers	924.0	1,266.0	1,299.0	33.0	150.0	9.0	8.0	8.4	20.2
TRW	1,379.0	1,698.0	1,860.0	162.0	174.0	26.0	9.1	41.9	3.3
UAL OP	1,135.0	1,478.9	1,653.3	174.4	183.4	73.8	6.2	24.7	89.7
UAL UP	272.1	412.1	368.9	-43.2	-	-	-	-	-
Union Carbide	1,636.0	2,100.0	2,078.0	-22.0	225.0	36.0	5.2	24.6	89.1
Unisys OP	2,054.0	2,696.4	2,748.3	51.9	347.4	49.9	6.8	23.8	41.5
Unisys UP	87.0	92.4	45.6	-46.8	-	-	-	-	-
United Tech. OP	3,695.0	4,564.4	5,429.5	865.1	-158.3	(17.3)	n.m.	42.6	76.6
United Tech. UP	334.5	442.5	215.4	-227.1	-	-	-	-	-
United Telecom	532.2	740.2	1,085.7	345.5	113.6	(1.9)	n.m.	11.1	28.4
USX	7,551.0	7,856.0	8,564.0	708.0	1,002.8	(234.0)	n.m.	44.0	132.8
US WEST	3,848.0	4,810.0	7,120.0	2,310.0	867.6	(67.1)	n.m.	31.8	49.4
Warner-Lambert	678.3	763.7	853.3	89.6	132.4	(21.3)	n.m.	31.6	67.9
Westinghouse	4,331.4	4,823.0	3,745.1	-1,077.9	366.1	101.3	11.0	23.1	114.1

Source: Pension and Investment Age, July 24, 1989, pp. 30-31

Exhibit 14


Multiple Interests and Diverse Stakeholders
Pension Fund Trustees
Beneficiaries
1. Retirement Benefits
2. Employment
3. Economic Growth
4. Other Interests
Plan sponsors
Corporations
The Public
Stakeholders
Contributions
Stable share prices, reliable owners and creditors, economic growth
Solvent funds, economic growth
with diverse interests

Source: The Report of the Governor's Task Force on Pension Fund Investment. Our Money's Worth. Governor Mario M. Cuomo, Chairman Ira M. Millstein and Director Lee Smith. June 1989. p.15

Exhibit 15

Turnover - New York Stock Exchange
(millions of shares)

	Reported Share Volume	Average of Shares Listed	Percent Turnover	Reported Trades (thousands)	Avg. Size of Trade
1955	649.6	3,505.3	19	n.a.	n.a.
1960	766.7	6,152.8	12	n.a.	n.a.
1965	1,556.3	9,643.6	16	n.a.	224
1970	2,937.4	15,573.6	19	7,566	388
1975	4,693.4	22,107.5	21	9,481	495
1980	11,352.3	31,871.0	36	13,015	872
1981	11,853.7	36,003.5	33	11,696	1,013
1982	16,458.0	38,907.0	42	12,609	1,305
1983	21,589.6	42,316.9	51	15,051	1,434
1984	23,071.0	47,104.8	49	12,954	1,781
1985	27,510.7	50,759.4	54	14,649	1,878
1986	35,680.0	56,023.8	64	18,972	1,881
1987	47,801.3	65,711.4	73	22,635	2,112
1988	40,849.5	73,947.7	55	17,739	2,303

Source: New York Stock Exchange 1989 Fact Book

Exhibit 16

Turnover of Institutional Holdings in Top 50 Corporations

COMPANY	1988 RANK*	INSTITUTIONAL TURNOVER (%) 1987	1988	CHANGE IN TURNOVER
IBM	1	84.4	59.7	-24.7
EXXON	2	33.9	25.6	-8.3
GENERAL ELECTRIC	3	52.4	38.8	-13.6
AT&T	4	55.5	38.2	-17.3
PHILIP MORRIS	5	99.5	78.2	-21.3
GENERAL MOTORS	6	90.0	63.1	-26.9
MERCK	7	101.3	56.5	-44.8
FORD MOTOR	8	106.9	56.9	-50.0
DU PONT	9	72.5	52.3	-20.2
AMOCO	10	42.7	35.1	-7.6
MOBIL	11	59.0	41.6	-17.4
RJR NABISCO	12	77.3	133.9	56.6
BELLSOUTH	13	33.0	24.9	-8.1
CHEVRON	14	53.5	38.3	-15.2
WAL-MART STORES	15	45.0	26.6	-18.4
COCA-COLA	16	59.3	46.0	-13.3
DOW CHEMICAL	17	107.5	90.6	-16.9
SEARS, ROEBUCK	18	59.3	50.8	-8.5
ATLANTIC RICHFIELD	19	74.4	48.9	-25.5
MINNESOTA MINING & MFG.	20	76.4	56.8	-19.6
PROCTER & GAMBLE	21	65.9	47.6	-18.3
JOHNSON & JOHNSON	22	83.7	56.9	-26.8
GTE	23	48.5	43.6	-4.9
EASTMAN KODAK	24	122.6	67.3	-55.3
BELL ATLANTIC	25	42.8	30.1	-12.7
PACIFIC TELESIS GROUP	26	54.1	34.6	-19.5
ELI LILLY	27	68.1	47.2	-20.9
AMERITECH	28	51.3	32.6	-18.7
NYNEX	29	52.0	40.4	-11.6
BRISTOL-MYERS	30	69.0	47.4	-21.6
SOUTHWESTERN BELL	31	41.5	41.9	0.4
DIGITAL EQUIPMENT	32	174.1	169.8	-4.3
TEXACO	33	137.5	117.8	-19.7
AMERICAN INT'L GP	34	58.2	43.7	-14.5
AMERICAN EXPRESS	35	97.4	54.9	-42.5
HEWLETT-PACKARD	36	80.1	64.9	-15.2
AMERICAN HOME PROD.	37	46.7	29.7	-17.0
ABBOT LABORATORIES	38	52.9	54.2	1.3
PEPSICO	39	73.9	56.0	-17.9
US WEST	40	47.3	31.5	-15.8
BOEING	41	93.4	90.2	-3.2
WALT DISNEY	42	97.0	69.1	-27.9
WASTE MANAGEMENT	43	88.0	62.6	-25.4
ANHEUSER-BUSCH	44	53.6	51.7	-1.9
MCDONALD'S	45	88.8	56.2	-32.6
PFIZER	46	77.4	59.3	-18.1
CITICORP	47	96.0	59.7	-36.3
DUN & BRADSTREET	48	50.9	45.8	-5.1
SCHLUMBERGER	49	72.6	57.3	-15.3
USX	50	112.1	67.4	-44.7
AVERAGE		74	56	-17.7

*Ranked by Stock Market Value

Note: Turnover equals percent of outstanding shares, changing hands in the designated year.

Source: Compiled from Business Week's Database on Top 1000 Corporations Ranked by Stock Market Values

Exhibit 17
p.1

Annual Percent Turnover of Equity Holdings All 137 Investment Advisors Ranked from Highest to Lowest Annual Percent Turnover (September 1988 - June 1989)

	NO. STKS	PORTF MIL$	---FOR THE QUARTER ENDED--- 09/88	12/88	03/89	06/89	--AVERAGE- PCNT	RNK
WESTRIDGE CAPITAL MGMT.	10	86	n/a	400.0	396.0	400.0	398.7	1
DEAN WITTER REYNOLDS INC	30	24	367.3	356.8	368.1	368.3	365.1	2
KELLNER, G A & CO.	12	40	n/a	341.7	n/a	n/a	341.7	3
SPEAR, LEEDS & KELLOGG	120	64	353.9	327.7	331.4	313.6	332.1	4
MERRILL LYNCH PIERCE F&S	91	58	315.3	336.8	262.0	340.5	313.6	5
BAUPOST GROUP, INC.	45	75	n/a	n/a	277.6	n/a	277.6	6
JUNCTION ADVISORS INC	41	475	n/a	n/a	244.4	286.7	265.6	7
PAINEWEBBER INC.	1371	638	312.6	218.6	246.3	264.9	260.6	8
ROBERT FLEMING INC.	31	17	n/a	257.4	n/a	n/a	257.4	9
WALSH GREENWOOD & CO.	18	109	n/a	n/a	254.5	251.1	252.8	10
NYE, RICHARD B.	19	214	249.2	n/a	n/a	n/a	249.2	11
SCHAFER CAP MGMT INC.	41	142	n/a	n/a	220.7	n/a	220.7	12
FORT HILL INVESTORS MGMT	35	184	154.3	n/a	n/a	284.9	219.6	13
ALPINE ASSOCS. LTD PTNR	61	534	213.7	225.8	212.5	215.1	216.8	14
MEEDER R & ASSOC. INC.	107	51	131.1	392.0	312.0	28.9	216.0	15
PARAMOUNT CAPITAL GROUP	97	137	239.9	222.6	204.7	196.3	215.9	16
DONALDSON LUFKIN & JEN	235	130	169.6	235.3	237.8	213.0	213.9	17
MESA LTD PARTNERSHIP	13	189	193.4	204.7	183.5	269.7	212.8	18
TARGET INVESTORS, INC.	10	57	324.1	131.8	178.0	n/a	211.3	19
SHERIFF SECURITIES CORP	49	97	129.0	198.3	285.4	213.8	206.6	20
FURMAN SELZ MAGER DIETZ	135	147	n/a	n/a	n/a	204.8	204.8	21
STATISTICAL SCIENCES INC	80	102	n/a	n/a	203.3	n/a	203.3	22
MCKENZIE WALKER INV MGMT	79	627	233.7	189.4	188.6	179.9	197.9	23
CILLUFFO, FRANK J.A.	10	66	n/a	n/a	192.0	188.0	190.0	24
BEACON CAPITAL MGMT CO	77	706	n/a	n/a	292.3	79.9	186.1	25
STEINHARDT, MICHAEL H.	219	1715	183.6	140.0	213.7	199.6	184.3	26
PARIBAS ASSET MGMT TECH	80	60	259.9	172.6	136.7	163.4	183.1	27
ALGER FRED ASSET MGMT.	40	17	171.3	106.5	324.8	123.3	181.5	28
CS FIRST BOSTON INC.	276	309	49.0	n/a	244.5	243.7	179.1	29
MARATHON ASSET MGMT. CO.	16	30	n/a	n/a	n/a	178.3	178.3	30
CAPITAL HOLDING CORP	102	255	185.0	171.7	167.3	170.7	173.7	31
SOROS FUND MANAGEMENT CO	182	1342	158.4	130.0	171.5	225.5	171.3	32
PHOENIX MUTUTAL LIFE INS	142	1051	189.0	138.4	191.0	162.8	170.3	33
CYPRESS CAPITAL MGMT	22	209	106.6	176.6	185.1	208.3	169.2	34
STRONG/CORNELIUSON CAP	240	2247	133.9	167.2	214.9	153.0	167.3	35
QUANTILOGIC ASSET MGMT	114	11	81.0	48.3	351.9	n/a	160.4	36
ZWEIG TOTAL RETURN ADVS.	63	121	n/a	n/a	174.8	145.2	160.0	37
GENERAL DYNAMICS CORP.	181	450	123.5	210.2	139.7	156.3	157.4	38
GENCORP, INC.	20	11	58.6	59.6	167.5	343.0	157.2	39
ARDSLEY PARTNERS	93	749	n/a	150.3	170.0	150.5	156.9	40
PRUDENTIAL-BACHE SECS.	411	1042	162.2	158.0	145.0	155.8	155.2	41
MERCHANTS NATL CORP	77	55	206.1	102.7	n/a	n/a	154.4	42
AXE-HOUGHTON MGMT. INC.	58	172	n/a	n/a	n/a	153.9	153.9	43
MANUFACTURERS LIFE INS	91	819	152.1	n/a	n/a	150.9	151.5	44
CAPITAL INTL. S.A.	24	39	72.6	n/a	n/a	230.1	151.3	45
AON CORPORATION	67	375	n/a	n/a	172.4	125.5	149.0	46
FURMAN SELZ CAPITAL MGMT	178	274	n/a	n/a	n/a	145.2	145.2	47
MATHERS & COMPANY INC	18	113	113.0	95.7	226.4	n/a	145.0	48
HELLMAN JORDAN MGMT CO	56	874	108.7	151.7	163.2	150.5	143.5	49
BRANDYWINE ASSET MGMT.	506	658	n/a	106.9	133.5	188.0	142.8	50
ROCKER, DAVID A	44	125	135.4	144.9	122.3	161.3	141.0	51
FINE, JERROLD N.	36	240	118.7	132.1	150.4	162.0	140.8	52

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CONNECTICUT MUTUAL LIFE	94	402	n/a	127.7	135.5	149.3	137.5	53
ATLANTIC RICHFIELD CO	147	723	122.6	129.0	153.5	144.0	137.3	54
NORTHERN CAPITAL MGMT	112	722	177.7	103.3	163.6	102.3	136.7	55
HAWTHORNE ASSOCIATES INC	134	338	23.8	18.8	257.3	246.8	136.7	56
BEAR STEARNS & CO.	370	1272	168.9	104.3	n/a	n/a	136.6	57
HAAVE R B ASSOCIATES INC	24	30	193.0	105.3	150.2	96.4	136.2	58
MCGLINN CAPITAL MGMT	178	658	121.2	146.0	134.5	138.9	135.2	59
DIETCHE & FIELD ADVS INC	36	266	n/a	114.5	133.1	156.6	134.7	60
PENN MUTUAL LIFE INS CO	140	107	n/a	106.8	154.8	n/a	130.8	61
CRABBE HUSON COMPANY	31	159	118.8	143.2	116.2	144.9	130.8	62
SCHUPF WOLTMAN & CO INC	12	21	130.3	n/a	n/a	n/a	130.3	63
WEISS, GEORGE ASSOCS INC	36	176	n/a	130.1	n/a	n/a	130.1	64
AVATAR INVESTORS ASSOC.	342	958	124.3	92.5	164.3	138.8	130.0	65
SLOATE WEISMAN MURRAY&CO	80	34	112.9	100.2	159.5	145.8	129.6	66
ZWEIG ADVISORS INC.	84	196	157.6	100.5	n/a	n/a	129.1	67
WERTHEIM SCHRODER & CO.	317	879	89.2	98.2	181.2	145.5	128.5	68
LUTHERAN BROTHERHOOD	89	396	124.2	101.1	105.8	182.9	128.5	69
SHEARSON L. INVT STRATGY	158	387	n/a	112.4	116.5	152.3	127.1	70
ALGER FRED MANAGEMENT	97	762	114.7	111.7	157.8	120.4	126.2	71
ASTROP ADVISORY CORP	46	136	208.1	121.9	85.9	88.2	126.0	72
AMOCO CORPORATION	168	271	n/a	26.4	238.7	111.5	125.5	73
MORGAN GRENFELL CAP MGMT	278	1436	102.4	88.9	124.1	180.8	124.0	74
INVESTORS RESEARCH CO.	93	104	n/a	n/a	n/a	122.8	122.8	75
NEW YORK LIFE INSURANCE	479	368	243.9	82.6	80.4	80.1	121.7	76
ODYSSEY PARTNERS	70	436	132.3	94.6	139.0	114.9	120.2	77
WILLOUGHBY HOLIN&RENTNER	65	89	105.7	102.9	121.5	150.0	120.0	78
VALUE LINE INC.	531	1801	146.1	n/a	110.7	99.3	118.7	79
G T CAPITAL MANAGEMENT	125	308	106.5	100.3	140.3	126.9	118.5	80
INVESTORS RESEARCH CORP	289	5210	149.1	116.3	106.2	97.6	117.3	81
LINCOLN NATL CORP	412	3085	n/a	n/a	116.7	n/a	116.7	82
FIRST INVESTORS MGMT CO	165	100	132.0	88.7	121.8	122.3	116.2	83
CNA FINANCIAL CORP	145	386	75.7	120.4	143.3	125.0	116.1	84
JANUS CAPITAL CORP.	104	680	142.7	67.7	125.8	122.7	114.7	85
FROLEY REVY INVESTMNT CO	69	72	n/a	89.8	139.4	n/a	114.6	86
YEAGER WOOD & MARSHALL	32	348	121.7	n/a	n/a	106.5	114.1	87
HUDSON CAPITAL ADVISORS	168	296	114.5	95.7	116.8	128.7	113.9	88
MUSIC CAPITAL MGMT.	128	677	93.6	108.5	116.1	136.6	113.7	89
BURGESS CAPITAL CORP.	12	30	32.4	n/a	n/a	193.2	112.8	90
MCMILLION/EUBANKS CAP.	111	66	n/a	62.3	146.3	129.4	112.7	91
WINCHESTER CAPITAL MGMT.	61	60	74.5	87.3	157.4	130.5	112.4	92
REIMER & KOGER ASSOCS	154	164	n/a	n/a	56.1	168.0	112.1	93
FORSTMANN-LEFF ASSOCS.	88	2382	91.2	133.7	109.5	n/a	111.4	94
HUTTON E F & COMPANY	459	2858	155.6	79.2	88.5	118.6	110.5	95
MACKAY SHIELDS FINANCIAL	181	943	51.9	87.6	164.1	136.9	110.1	96
MCSTAY JOHN INVT COUNSEL	114	308	n/a	n/a	n/a	109.8	109.8	97
WASATCH ADVISORS INC	44	65	94.4	98.2	61.6	184.2	109.6	98
SACHS MORTON H & CO.	63	149	108.0	153.6	88.8	87.7	109.5	99
AON ADVISORS, INC.	72	165	75.4	133.1	161.0	61.9	107.6	100
SIXTY-ONE ASSOCIATES	270	216	96.8	110.3	105.2	117.8	107.5	101
STRATEGIC INVT PARTNERS	58	34	n/a	n/a	52.3	162.2	107.3	102
FINANCIAL PROGRAMS INC	235	715	102.5	112.0	n/a	n/a	107.3	103
PACIFIC MUTUAL LIFE INS	508	601	57.1	128.2	135.3	n/a	106.9	104

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BJURMAN GEORGE D & ASSOC	88	165	n/a	n/a	147.8	64.0	105.9	105
TRW INVESTMENT MGMT CO	68	97	43.1	268.2	99.7	50.6	105.4	106
ASSOCIATED CAPITAL INVTS	113	545	n/a	n/a	n/a	105.2	105.2	107
FOUNDERS MUTUAL DEPOSITR	164	346	74.3	141.0	99.9	n/a	105.0	108
MORGAN STANLEY GROUP INC	789	3173	94.5	93.4	124.1	n/a	104.0	109
SECURITIES COUNSEL, INC.	208	513	n/a	n/a	n/a	103.8	103.8	110
WADDELL & REED INC	344	3208	85.6	91.0	113.6	124.3	103.6	111
HANCOCK JOHN MUTUAL LIFE	44	96	n/a	n/a	n/a	103.4	103.4	112
WALL STREET ASSOCIATES	46	142	106.4	84.5	99.0	121.7	102.9	113
A I M MGMT GROUP INC.	233	701	130.6	79.1	97.1	102.4	102.3	114
PILGRIM BAXTER GREIG	176	1095	90.2	120.7	102.5	93.7	101.8	115
KIRR MARBACH & COMPANY	132	218	115.2	82.8	104.9	104.0	101.7	116
VALUE EQUITY ASSOCS I LP	19	110	n/a	n/a	118.8	83.6	101.2	117
ATALANTA/SOSNOFF CAPITAL	71	1456	100.3	n/a	n/a	n/a	100.3	118
WALL PATTERSON HAMILTON	114	417	91.9	n/a	n/a	108.1	100.0	119
LEGAL & GENERAL GROUP	303	694	59.3	66.7	93.2	179.4	99.6	120
DREYFUS CORPORATION	303	2344	n/a	74.4	110.3	113.9	99.5	121
PELL RUDMAN & CO., INC.	72	133	72.2	133.4	111.3	79.4	99.1	122
CHUBB CORPORATION	72	413	n/a	n/a	n/a	98.1	98.1	123
FRIESS ASSOCIATES INC.	86	651	75.1	112.4	95.3	105.4	97.0	124
PEOPLES BANK/CT	212	174	69.9	96.1	123.9	95.2	96.3	125
DREYFUS MANAGEMENT INC	63	221	95.8	77.3	84.7	127.0	96.2	126
NATIONAL INVT SVC/AMER	102	184	175.1	60.4	66.6	81.6	95.9	127
ROTHSCHILD ASSET MGMT	110	178	67.3	90.2	127.5	97.6	95.6	128
BREEN, DANIEL & COMPANY	101	701	n/a	n/a	n/a	95.6	95.6	129
AMHERST INVESTMENT CO	138	110	81.7	107.2	n/a	n/a	94.5	130
POTOMAC ASSET MGMT. INC.	82	77	58.7	42.8	55.7	220.4	94.4	131
CAMPBELL ADVISORS INC	89	451	123.7	63.9	102.8	83.6	93.5	132
WARBURG INVT MGMT INTL	40	165	n/a	n/a	n/a	93.2	93.2	133
SIRACH/FLINN ELVINS CAP	66	433	91.4	81.6	115.8	83.2	93.0	134
TCW ASSET MGMT CO	659	4843	n/a	n/a	103.1	81.2	92.2	135
PILGRIM MANAGEMENT CORP	97	323	84.9	79.1	111.1	n/a	91.7	136
AMERICAN INTL GROUP INC	159	940	62.2	106.6	114.7	80.6	91.1	137
LEVIN, JOHN A & CO. INC.	319	840	87.6	n/a	n/a	93.2	90.4	138
ROBERTSON JULIAN H JR	49	503	56.2	136.3	83.4	81.9	89.5	139
BENEFIT CAP(UNION CARB.)	144	459	119.7	74.5	96.8	65.6	89.2	140
NICHOLAS-APPLEGATE CAP.	449	1528	97.8	76.9	89.1	92.8	89.1	141
HARBOR CAPITAL MGMT CO	92	501	76.4	n/a	n/a	101.3	88.8	142
UNITED SVCS ADVISORS INC	90	77	192.8	49.9	66.2	46.5	88.8	143
SECURITY MANAGEMENT CO.	212	801	104.4	n/a	n/a	72.5	88.5	144
SHEARSON LEHMAN HUTTON	972	10681	92.3	n/a	n/a	84.6	88.4	145
IVY MANAGEMENT INC	137	166	n/a	n/a	n/a	88.1	88.1	146
KEYSTONE INVESTMENT MGMT	60	213	n/a	105.7	70.4	n/a	88.1	147
ROANOKE ASSET MANAGEMENT	91	490	90.3	84.9	n/a	n/a	87.6	148
MUTUAL OF AMERICA LIFE	123	402	59.2	46.6	69.8	172.8	87.1	149
HAHN HOLLAND & GROSSMAN	259	342	62.2	84.6	96.2	104.9	87.0	150
REAMS ASSET MGMT CO INC	76	513	70.7	54.0	98.9	122.2	86.4	151
KIDDER PEABODY & CO	428	853	89.8	n/a	n/a	82.2	86.0	152
BERGER ASSOCIATES INC	35	33	135.2	36.5	n/a	n/a	85.9	153
LYON STUBBS & TOMPKINS	109	127	68.1	n/a	n/a	103.7	85.9	154
LEAVY INVT MANAGEMENT	39	178	67.1	60.0	108.6	103.2	84.7	155
INVESTMENT ADVISORS INC	82	261	63.3	103.6	n/a	n/a	84.5	156

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MORSE WILLIAMS & CO INC	111	54	66.1	91.4	97.9	81.0	84.1	157
NEW ENGLAND ASSET MGMT.	38	69	54.9	81.6	64.4	133.7	83.7	158
BARING AMERICA ASSET MGT	131	527	75.1	46.5	63.6	145.6	82.7	159
INDEPENDENCE INVT ASSOC.	267	2843	71.6	92.1	71.5	94.7	82.5	160
INSTITUTIONAL CAPITAL CO	35	699	87.4	70.2	78.7	92.3	82.2	161
OPPENHEIMER MGMT. CORP.	525	2482	80.6	76.9	78.9	91.4	81.9	162
ALLSTATE RETIREMENT PLAN	193	286	67.3	95.8	n/a	n/a	81.6	163
ALLSTATE AGENTS PENSION	167	212	66.5	96.2	n/a	n/a	81.4	164
SIEBEL CAPITAL MGMT	111	585	70.1	n/a	n/a	92.6	81.3	165
MOUNT VERNON ASSOCS. INC	33	124	64.7	76.3	52.3	131.1	81.1	166
KEMPER FINL SERVICES	227	5184	n/a	81.1	n/a	n/a	81.1	167
CHIEFTAIN CAPITAL MGMT.	15	180	52.9	116.5	81.2	73.4	81.0	168
FIDELITY INTERNATL LTD	419	1062	57.4	82.7	102.5	n/a	80.9	169
ALLSTATE INSURANCE CO	257	1525	67.8	75.7	90.4	89.4	80.8	170
AXE CORE INVESTORS INC	540	861	n/a	n/a	n/a	80.8	80.8	171
KENNEDY ASSOCIATES INC	82	323	n/a	89.4	72.8	80.1	80.8	172
EQUITY INVESTMENT CORP.	36	14	n/a	n/a	n/a	80.3	80.3	173
GOLLUST TIERNEY & OLIVER	42	456	n/a	82.9	58.7	98.2	79.9	174
CHASE MANHATTAN CORP	831	5884	48.7	99.7	57.7	113.3	79.9	175
RIEGER ROBINSON HARRNGTN	87	169	48.0	n/a	n/a	110.7	79.4	176
EQUITABLE LIFE ASSUR/US	571	4894	73.1	n/a	n/a	85.3	79.2	177
MNC FINANCIAL INC.	814	2465	n/a	n/a	n/a	79.1	79.1	178
SOUND SHORE MGMT. INC.	54	522	91.5	64.4	57.0	103.1	79.0	179
GENERAL MOTORS CORP IAMG	110	1499	122.6	53.0	57.7	81.5	78.7	180
ALLSTATE LIFE INSURANCE	147	180	64.2	87.5	n/a	83.5	78.4	181
NORTHWESTERN MUTUAL LIFE	329	1623	65.2	n/a	n/a	91.3	78.3	182
CRESTAR BANK/VIRGINIA	637	1897	n/a	n/a	78.1	n/a	78.1	183
HIBERNIA NATIONAL BANK	252	428	82.6	74.1	50.3	104.3	77.8	184
LAWRENCE C J/MORGAN GRNF	143	167	50.9	101.8	66.5	89.2	77.1	185
GRANTHAM MAYO VAN OTTER	419	3342	n/a	n/a	79.8	74.1	77.0	186
GLICKENHAUS & CO.	273	1242	92.4	64.9	63.4	78.3	74.8	187
WESTWOOD MANAGEMENT CORP	35	671	n/a	n/a	74.8	73.2	74.0	188
SCHAFER CAP MGMT COMPANY	35	251	73.4	n/a	n/a	n/a	73.4	189
SCHMEIDLER A R & CO INC	51	70	51.9	94.5	n/a	n/a	73.2	190
SHIELDS ASSET MGMT INC	303	1200	52.4	71.1	70.4	98.6	73.1	191
HEINE SECURITIES CORP	315	2897	80.9	68.9	74.7	66.9	72.9	192
SASS MARTIN D	195	1492	79.2	59.4	72.3	79.6	72.6	193
BEA ASSOCIATES INC	302	1955	65.8	55.4	58.4	110.3	72.5	194
GREAT WEST LIFE ASSUR CO	84	214	n/a	n/a	80.3	64.5	72.4	195
FRONTIER CAPITAL MGMT CO	339	787	77.0	n/a	n/a	67.8	72.4	196
COWEN & COMPANY	182	261	71.3	73.2	n/a	n/a	72.3	197
PEREGRINE CAPITAL MGMT	127	773	61.4	60.7	85.1	80.7	72.0	198
SIGNET TRUST COMPANY/VA	192	594	9.6	174.6	n/a	31.4	71.9	199
SOUTHEASTERN ASSET MGMT	73	1407	70.9	n/a	n/a	72.6	71.8	200
FLORIDA NATL BANKS/FLA	237	488	84.2	n/a	n/a	58.5	71.4	201
NEUBERGER&BERMAN MGMT	309	1895	n/a	n/a	n/a	71.3	71.3	202
GINTEL EQUITY MANAGEMENT	34	188	96.3	51.4	57.8	79.5	71.3	203
ROSENBERG INST. EQ. MGMT	760	6187	60.2	63.8	77.1	83.8	71.2	204
BLUM, RICHARD C & ASSOCS	10	195	n/a	n/a	n/a	71.2	71.2	205
HOWARD SAVINGS BANK	52	35	59.5	63.5	90.4	n/a	71.1	206
JAMES INVT RESEARCH INC	178	210	79.0	81.2	63.6	59.3	70.8	207
PREMIER INVESTMENT ADVS.	83	79	43.2	162.0	59.0	18.9	70.8	208

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STOCK YARDS BANK & TRUST	82	164	19.7	53.3	69.3	140.5	70.7	209
COLUMBIA MANAGEMENT CO	318	3009	64.6	61.4	81.3	75.4	70.7	210
FIRST OF AMERICA BANK	218	373	74.4	66.8	n/a	n/a	70.6	211
PALM BEACH CAPITAL MGMT.	175	220	67.8	74.5	63.6	75.6	70.4	212
SHEARSON ASSET MGMT INC	411	2022	112.6	63.0	52.5	53.2	70.3	213
CMB INVESTMENT COUNSELOR	138	213	72.7	57.0	51.0	99.4	70.0	214
TRANSAMERICA CORP	287	719	81.5	n/a	58.0	n/a	69.8	215
LAZARD FRERES & CO	369	10679	67.2	71.5	65.0	73.6	69.3	216
IRVING TRUST COMPANY	705	1449	18.4	113.7	107.3	34.7	68.5	217
ANALYTIC INVESTMENT MGMT	757	1189	68.4	n/a	n/a	n/a	68.4	218
DISCIPLINED INVT ADVISOR	232	989	91.2	70.2	42.9	68.1	68.1	219
HORISON ASSET MGMT.	39	106	n/a	n/a	64.0	70.9	67.4	220
FIRST INTERSTATE/DENVER	297	1898	64.1	73.3	64.4	67.7	67.4	221
WEDGE CAPITAL MGMT. INC.	30	574	n/a	66.9	33.5	100.6	67.0	222
FIRST QUADRANT CORP	110	1014	43.4	n/a	n/a	90.3	66.9	223
ALLIED CORPORATION	72	392	57.0	56.2	90.3	63.3	66.7	224
CALVERT ASSET MGMT. CO.	83	96	74.7	60.6	54.0	77.1	66.6	225
C-B CAPITAL ADVISORS INC	100	189	70.3	61.7	67.6	66.4	66.5	226
STATE STREET RESR & MGMT	303	6613	68.4	57.6	61.8	78.2	66.5	227
SAXON WOODS ASSET MGMT.	387	1715	58.2	77.9	67.5	61.6	66.3	228
INVESTMENT ADVISERS INC	218	1703	52.0	45.1	73.8	93.0	66.0	229
KINGSLEY JENNISON MCNLTY	75	83	51.3	n/a	n/a	80.2	65.8	230
PROVIDENT INVT COUNSEL	162	2482	67.7	63.8	n/a	n/a	65.8	231
OHIO CASUALTY CORP	84	325	61.7	58.1	79.6	62.3	65.4	232
PCB TRUST COMPANY	431	152	n/a	n/a	62.9	67.2	65.0	233
CRAMER ROSENTHAL MCGLYNN	119	243	65.4	n/a	n/a	64.7	65.0	234
STERLING CAPITAL MGMT	36	497	n/a	64.9	n/a	n/a	64.9	235
CUMBERLAND ASSOCIATES	145	604	72.6	48.0	67.8	69.7	64.5	236
WEISS PECK & GREER	567	2539	59.1	53.8	70.8	74.3	64.5	237
NEUBERGER & BERMAN	881	3450	79.0	n/a	n/a	49.8	64.4	238
CASHMAN FARRELL & ASSOC	147	1746	74.7	53.7	64.5	63.8	64.2	239
ARONSON & FOGLER	245	156	50.0	109.7	23.4	73.2	64.1	240
GENERAL ELECTRIC COMPANY	55	440	41.3	48.4	102.3	n/a	64.0	241
TEXTRON INC	37	348	29.9	63.4	90.0	72.5	64.0	242
BMI CAPITAL CORPORATION	72	451	68.8	69.1	58.4	59.2	63.9	243
COLUMBIA SVGS & LOAN	31	277	n/a	n/a	48.1	79.5	63.8	244
JENNISON ASSOC CAPITAL	122	6520	61.8	55.4	62.7	75.0	63.7	245
FIDUCIARY MGMT ASSOC INC	93	422	70.4	48.0	51.2	84.9	63.6	246
LEXINGTON CAPITAL MGMT.	110	239	n/a	n/a	51.4	75.2	63.3	247
VALUEQUEST LTD.	55	292	19.5	n/a	n/a	107.2	63.3	248
GREENHAVEN ASSOCS., INC.	47	259	n/a	n/a	62.0	64.4	63.2	249
PUTNAM MANAGEMENT CO INC	720	7872	55.5	60.1	53.8	73.1	63.1	250
BATTERYMARCH FINL MGMT	599	7491	n/a	n/a	64.8	61.1	62.9	251
ANDERSON HOAGLAND & CO.	53	154	46.4	n/a	n/a	79.4	62.9	252
BARCLAYS BANK PLC	357	1764	65.4	n/a	n/a	60.2	62.8	253
INTEGRATED RES. ASSET	187	743	65.0	57.2	58.0	70.2	62.6	254
MERIDIAN BANCORP INC.	248	514	60.7	47.3	72.5	69.7	62.6	255
AMEV ADVISERS INC	166	387	80.9	n/a	n/a	43.9	62.4	256
THOMSON HORSTMANN&BRYANT	101	128	51.7	50.9	70.6	75.8	62.3	257
CFB ADVISORY CORPORATION	387	468	n/a	n/a	90.8	33.5	62.1	258
BAILARD BIEHL & KAISER	147	192	n/a	n/a	n/a	62.1	62.1	259
GREENE DAVID J & COMPANY	126	808	73.8	n/a	n/a	50.3	62.0	260

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UNIFIED MANAGEMENT CORP	129	41	n/a	60.0	49.3	76.3	61.9	261
ADDISON CAPITAL MGMT.	322	148	42.5	n/a	n/a	81.2	61.9	262
GEEWAX TERKER & COMPANY	606	2469	68.5	55.6	61.0	n/a	61.7	263
BEUTEL GOODMAN CAP MGMT	40	636	67.3	n/a	n/a	56.0	61.6	264
SUN BANKS OF FLORIDA	459	3921	60.6	65.4	58.5	n/a	61.5	265
ARNHOLD & S.BLEICHROEDER	130	433	69.2	53.7	n/a	n/a	61.5	266
JOHNSON, TOM INVT. MGMT.	48	385	63.7	46.0	76.8	59.0	61.4	267
LAIRD NORTON TRUST CO	130	133	64.9	61.8	63.2	54.8	61.2	268
WIDMANN, SIFF & CO. INC.	69	330	n/a	52.2	83.3	47.9	61.1	269
ROULSTON & COMPANY INC	40	148	50.6	47.9	56.7	89.0	61.1	270
SWISS REINSURANCE CO	300	649	n/a	n/a	n/a	60.8	60.8	271
NWQ INVESTMENT MGMT CO	128	1034	n/a	n/a	n/a	60.8	60.8	272
BAIRD, ROBERT W & CO INC	93	103	14.2	n/a	n/a	107.0	60.6	273
NEUBERGER&BERMAN PENSION	554	3825	69.8	n/a	n/a	51.3	60.6	274
GTE INVT. MGMT. CORP.	324	740	57.8	68.6	24.7	90.7	60.5	275
LOOMIS SAYLES & COMPANY	433	10468	60.3	53.8	63.8	63.4	60.3	276
ROCKEFELLER UNIVERSITY	33	110	71.1	26.2	83.4	60.3	60.2	277
MINIS & CO., INC.	62	58	n/a	n/a	67.4	52.9	60.1	278
ST GERMAIN, D J CO. INC.	38	125	22.8	46.5	85.0	85.8	60.0	279
ROLL & ROSS ASSET MGMT.	287	518	n/a	n/a	30.6	89.3	60.0	280
LEGG MASON CAPITAL MGMT	34	125	62.7	47.3	66.6	63.3	60.0	281
LEXINGTON MANAGEMENT CO	171	979	36.2	74.9	51.5	76.9	59.9	282
DUPONT E I DE NEMOURS	605	5335	n/a	47.1	67.8	64.4	59.8	283
WEISS ASSET MGMT. L.P.	92	1250	n/a	59.8	n/a	n/a	59.8	284
DIGITAL EQUIP PENSION TR	58	410	35.3	71.2	67.8	64.5	59.7	285
STUYVESANT CAPITAL MGMT	46	30	29.2	62.7	84.5	62.3	59.7	286
SIT INVESTMENT ASSOCS.	170	2182	n/a	n/a	65.3	54.0	59.7	287
KEYSTONE FINANCIAL INC.	211	116	43.8	111.0	24.0	n/a	59.6	288
HEARTLAND CAPITAL MGMT.	44	208	42.5	58.2	86.5	50.6	59.5	289
MILLBROOK ADVISORS INC	38	23	18.5	45.0	121.4	52.5	59.3	290
FMR CORP	1983	31240	48.3	58.9	59.3	70.7	59.3	291
HONGKONG & SHANGHAI BKG	381	1875	n/a	70.3	23.2	83.4	59.0	292
NCNB CORPORATION	871	6335	29.1	26.2	29.7	149.9	58.8	293
FERGUSON & WELLMAN INC	73	138	72.9	53.8	75.0	33.3	58.7	294
JOHNSON INVT COUNSEL INC	58	111	n/a	49.9	83.2	43.0	58.7	295
EAGLE MGMT & TRUST CO	88	195	49.9	48.7	63.6	72.0	58.6	296
CAPITAL SUPERVISORS	111	1960	45.8	69.0	66.7	52.2	58.4	297
SHAWMUT CORPORATION	214	1627	n/a	n/a	80.2	36.4	58.3	298
NORWEST BANK/DES MOINES	366	123	87.1	n/a	n/a	29.5	58.3	299
SPRINGMAN, GEORGE B INC.	47	228	72.2	39.5	58.8	62.2	58.2	300
HARVARD COLLEGE	665	1820	61.0	n/a	n/a	55.4	58.2	301
CHICAGO ASSET MANAGEMENT	35	298	40.6	67.5	80.5	43.6	58.0	302
MONTAG & CALDWELL	71	401	63.8	65.2	50.0	53.2	58.0	303
DEPOSIT GUARANTY NATL BK	158	164	41.6	61.5	59.2	69.4	58.0	304
AMERICAN CAPITAL MGT&RES	472	5076	61.4	55.8	56.2	57.9	57.8	305
JUNDT/CAPEN ASSOCIATES	75	1403	27.0	50.8	83.2	70.2	57.8	306
CHASE INVESTMENT COUNSEL	39	95	55.7	36.2	45.7	91.9	57.4	307
TRINITY INVESTMENT MGMT	133	5768	66.3	53.5	54.5	53.6	57.0	308
MITCHELL HUTCHINS INST.	569	1457	49.1	40.4	55.6	82.8	57.0	309
CANNELL, PETER B & CO	56	147	63.6	35.7	47.1	81.3	56.9	310
SIGMA ASSET MGMT. INC.	86	76	n/a	56.8	n/a	n/a	56.8	311
SECURITIES COUNSELORS/IA	48	373	59.5	61.0	40.9	65.4	56.7	312

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FIFTY600 INC/ROCKEFELLER	176	659	60.9	n/a	n/a	51.9	56.4	313
WESTPORT ASSET MGMT INC	78	278	n/a	n/a	n/a	56.4	56.4	314
PALLEY-NEEDELMAN ASSET	70	224	111.7	33.6	46.7	32.8	56.2	315
ANCHOR CAPITAL ADVISORS	82	101	34.4	50.0	78.7	61.3	56.1	316
COMERICA INC	317	1336	75.9	38.9	46.4	63.1	56.1	317
ESSEX INVESTMENT MGMT CO	249	653	n/a	55.9	n/a	n/a	55.9	318
BRANCH BANKING & TRUST	138	174	n/a	n/a	51.9	59.8	55.8	319
WENTWORTH HAUSER&VIOLICH	133	405	44.6	29.3	97.7	51.2	55.7	320
MUNDER CAPITAL MGMT. INC	111	287	75.5	48.3	57.2	41.4	55.6	321
COMPU-VAL INVESTMENTS	77	244	41.4	56.4	51.3	73.2	55.6	322
GEICO CORPORATION	35	562	53.9	68.3	39.5	60.0	55.4	323
GUARDIAN INVESTOR SVCS.	128	348	50.5	n/a	n/a	60.2	55.3	324
WHEAT INVESTMENT ADVS.	149	316	n/a	67.9	45.6	50.7	54.7	325
MARK, MORRIS	69	323	n/a	n/a	44.7	64.5	54.6	326
TRAVELERS CORP	1904	5075	73.7	43.5	44.7	56.0	54.5	327
MAINE NATIONAL BANK	199	274	14.2	94.7	n/a	n/a	54.5	328
WOLF WEBB BURK & CAMPBLL	47	238	n/a	n/a	n/a	54.3	54.3	329
SMITH BARNEY INC	1111	1640	43.5	51.4	50.9	70.9	54.2	330
MCCULLOUGH ANDREWS&CAPP.	90	454	n/a	n/a	56.7	51.6	54.2	331
HANCOCK JOHN GROWTH TRST	68	90	52.1	44.8	42.9	76.7	54.1	332
MITCHELL HUTCHINS ASSET	518	1645	53.6	52.1	56.7	n/a	54.1	333
SELIGMAN J W & COMPANY	415	2716	51.5	32.9	54.8	77.2	54.1	334
BISHOP TRUST COMPANY LTD	92	227	52.4	51.4	37.6	74.5	54.0	335
FIRST SOURCE BANK	166	125	60.4	44.3	55.9	54.9	53.9	336
AFA FINANCIAL, INC.	40	137	94.2	22.3	71.0	27.6	53.8	337
SCHAENEN WOOD & ASSOCS.	80	203	45.8	62.4	52.5	n/a	53.6	338
GILLESPIE ROBINSON & CO	52	38	74.5	32.8	30.7	75.4	53.4	339
RICE HALL JAMES & ASSOC	181	396	n/a	n/a	52.7	53.3	53.0	340
CONCORD CAPITAL MGMT.	177	2308	39.1	44.5	67.7	60.5	53.0	341
EXECUTIVE LIFE INS CO	64	306	55.2	64.3	48.3	44.0	52.9	342
BERNSTEIN MACAULAY INC	332	683	49.3	25.2	86.7	49.7	52.7	343
MCKEE C S & CO INC	63	364	62.6	13.1	63.2	71.8	52.6	344
EAGLE ASSET MGMT. INC	190	1841	41.6	n/a	n/a	63.5	52.6	345
BIL, TRAINER WORTHAM INC	275	516	56.5	48.6	n/a	n/a	52.5	346
CHANCELLOR CAPITAL MGMT.	759	4746	n/a	n/a	n/a	52.5	52.5	347
BARTLETT & CO.	244	517	n/a	52.2	n/a	n/a	52.2	348
SHOOT MILLER CHENEY & CO	90	737	26.7	55.4	78.6	48.0	52.2	349
USAA INVESTMENT MGMT	187	1590	n/a	36.1	66.2	53.3	51.9	350
GREENLEAF CAPITAL MGMT.	87	149	35.3	37.8	58.5	75.5	51.8	351
SANDLER, HARVEY	50	742	50.7	n/a	n/a	52.8	51.8	352
TRUSTCORP, INC.	488	1196	8.7	51.7	120.2	26.4	51.7	353
ALLIANCE CAPITAL MGMT	1681	20127	46.6	46.8	52.1	61.2	51.7	354
STEINBERG ASSET MGMT CO.	50	222	37.4	55.6	61.8	n/a	51.6	355
MASSACHUSETTS FINL SVCS	429	4602	51.7	n/a	n/a	51.2	51.4	356
HGK ASSET MANAGEMENT	35	161	54.8	37.1	41.8	72.0	51.4	357
BESSEMER TRUST CO N.A.	257	1514	32.7	46.5	60.0	66.2	51.3	358
FIDUCIARY MGMT. INC.	62	257	47.2	37.5	65.8	54.6	51.3	359
CORNELL UNIVERSITY	55	267	38.9	n/a	59.9	54.8	51.2	360
UNITED STATES TR/CALIF	149	108	n/a	n/a	55.6	46.8	51.2	361
REAVES W. H. & CO. INC.	63	822	48.2	n/a	n/a	53.5	50.9	362
RUSSELL FRANK CO INC	918	2220	42.7	45.2	56.5	58.6	50.8	363
MIDLAND BANK PLC	192	358	27.2	62.6	61.6	n/a	50.5	364

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BROWN BRTHRS HARRIMAN&CO	294	882	n/a	26.9	97.8	26.2	50.3	365
CHICAGO CORPORATION	262	523	86.6	28.9	34.5	n/a	50.0	366
UNIVERSITY OF ROCHESTER	137	119	30.0	n/a	n/a	70.0	50.0	367
FIRST AMERICAN CORP	167	521	84.1	49.2	29.9	36.5	49.9	368
BANCOHIO NATIONAL BANK	410	542	n/a	n/a	51.9	47.8	49.9	369
CULLEN/FROST BANKERS INC	191	463	55.4	44.3	n/a	n/a	49.9	370
GAMCO INVESTORS INC	185	2740	41.2	39.4	56.1	62.2	49.7	371
GENERAL AMERICAN INVTS	59	1028	27.4	59.0	68.3	44.0	49.7	372
KANNE PARIS & HOBAN, INC	105	79	44.1	24.3	26.6	102.4	49.4	373
LIEBER & CO	442	889	46.9	46.3	48.9	54.6	49.2	374
DELAFIELD ASSET MGMT	96	643	49.5	46.1	39.4	61.6	49.1	375
BESSEMER TRUST COMPANY	157	494	36.9	42.3	54.9	62.4	49.1	376
BEEKMAN CAPITAL MGMT LTD	38	48	28.1	54.2	61.6	51.9	49.0	377
STEWART, W.P. & CO. INC.	54	1234	47.7	n/a	n/a	50.2	48.9	378
NEWELL ASSOCIATES	81	314	24.2	61.1	34.4	75.3	48.8	379
NEWBOLDS ASSET MANAGEMNT	57	2557	37.0	n/a	n/a	60.1	48.5	380
COLORADO PUBLIC EMPL RET	634	2559	13.5	55.3	54.7	70.6	48.5	381
AUSTIN & CALVERT INC.	219	319	33.5	63.5	n/a	n/a	48.5	382
TODD INVESTMENT ADVISORS	74	74	58.2	33.7	42.4	59.6	48.5	383
CITICORP	725	7760	26.3	105.5	28.2	33.7	48.4	384
FIRST PACIFIC ADVISORS	130	1236	45.6	49.7	47.6	50.5	48.3	385
NEWSOUTH CAPITAL MGMT.	44	379	30.1	n/a	n/a	66.3	48.2	386
MORAN ASSET MANAGEMENT	33	403	31.6	48.3	60.4	52.1	48.1	387
ARIEL CAPITAL MGMT INC	51	855	77.8	48.1	40.7	25.1	47.9	388
LINCOLN CAPITAL MGMT CO	43	3004	41.5	53.9	n/a	n/a	47.7	389
HARTFORD STEAM BOILER	99	303	n/a	n/a	52.5	42.6	47.5	390
AMA ADVISERS, INC.	188	131	n/a	50.6	46.9	44.9	47.5	391
GLOBE FINLAY INC.	17	124	38.4	63.6	40.5	n/a	47.5	392
CARRET AND COMPANY INC	195	217	21.2	20.8	100.4	n/a	47.4	393
NORWEST CORPORATION	296	115	62.6	58.6	32.2	36.2	47.4	394
THOMPSON/RUBINSTEIN INVT	51	123	n/a	47.4	n/a	n/a	47.4	395
BANCOKLAHOMA TRUST CO.	310	960	45.3	n/a	56.7	39.6	47.2	396
PRICE T ROWE ASSOCIATE	900	4976	44.0	36.5	42.1	65.6	47.0	397
STANDISH AYER & WOOD INC	212	769	n/a	41.4	47.2	52.5	47.0	398
WOOD STRUTHERS&WINTHROP	335	472	38.4	57.0	34.2	58.1	46.9	399
FLORIDA ST BOARD/ADMIN.	401	3327	n/a	49.0	30.3	60.5	46.6	400
FEDERATED INVT COUNSELNG	41	264	45.2	29.2	72.9	38.3	46.4	401
SCHRODER CAP MGMT INTL.	211	124	44.6	44.5	45.7	50.5	46.3	402
HAMILTON BANK	128	274	52.2	37.3	47.9	47.9	46.3	403
RCM CAPITAL MANAGEMENT	421	7155	44.6	48.1	46.8	45.8	46.3	404
ST PAUL COMPANIES INC	199	720	45.9	40.8	57.7	40.7	46.3	405
NATL RURAL ELEC COOP	91	350	54.6	30.1	48.7	51.3	46.1	406
SENA WELLER ROHS WMS INC	126	186	41.5	47.2	33.3	62.3	46.1	407
IDS FINANCIAL CORP.	504	9454	37.4	41.9	51.8	52.7	46.0	408
MERRILL LYNCH ASSET MGMT	618	7316	47.4	34.9	50.9	49.4	45.6	409
AID ASSOC FOR LUTHERANS	84	191	54.8	n/a	n/a	36.0	45.4	410
LOWE BROCKENBROUGH&TIERN	141	509	41.4	49.3	n/a	n/a	45.3	411
OPPENHEIMER GROUP INC	574	6835	43.6	36.9	48.9	51.7	45.3	412
FREEDOM CAPITAL MGMT.	226	241	37.4	54.8	46.3	42.5	45.3	413
IBJ SCHRODER BANK & TR	155	281	33.1	57.3	n/a	n/a	45.2	414
DEERE & COMPANY	685	1363	26.6	63.3	n/a	n/a	44.9	415
CAPITAL TECHNOLOGY INC.	203	185	n/a	n/a	29.4	60.4	44.9	416
STEIN ROE & FARNHAM	550	4309	40.1	37.7	44.7	56.1	44.7	417

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FIRST EASTERN BANK, NA	94	132	38.0	54.5	33.8	52.2	44.6	418
KAMPEL, DANIEL S ASSOC.	58	272	29.2	31.5	30.7	85.6	44.3	419
FEDERATED INVESTORS INC	110	1014	40.0	30.7	69.8	36.3	44.2	420
INVESTMENT COUNSEL CO	57	62	34.8	n/a	n/a	[illegible]3.4	44.1	421
BARNETT BANKS TRUST CO	408	1434	33.9	22.7	61.7	58.0	44.1	422
CONTINENTAL BANK, N.A.	393	2176	15.3	32.1	110.7	17.9	44.0	423
AMERICAN ASSET MGMT. CO.	131	262	47.5	38.2	53.3	36.8	44.0	424
CIGNA CORPORATION	450	4076	46.2	37.3	36.4	55.3	43.8	425
BECKER, P.E. INC.	76	138	33.7	42.7	54.7	n/a	43.7	426
FIRST AMERICAN BANKSHRS	267	471	34.5	n/a	n/a	52.8	43.7	427
UNION PLANTERS NATL BANK	31	18	62.7	n/a	n/a	24.6	43.6	428
BRADISON & COMPANY INC.	143	148	47.4	37.9	52.9	36.1	43.6	429
STRATTON MANAGEMENT CO.	92	255	54.0	20.3	46.0	54.0	43.6	430
SECURITY PACIFIC CORP	761	4803	51.7	n/a	n/a	35.3	43.5	431
CENTRAL BANCSHARES/SOUTH	123	201	n/a	n/a	46.8	40.0	43.4	432
WMG COMPANY	82	205	43.1	n/a	n/a	42.9	43.0	433
NEW JERSEY NATIONAL BANK	145	219	34.4	32.8	34.9	69.6	42.9	434
SOUTHEAST BANKING CORP	312	903	19.5	51.5	63.7	36.5	42.8	435
FIRST CHICAGO INVT ADVS	476	2330	38.1	47.4	n/a	n/a	42.8	436
AMERICAN GENERAL CORP	465	1742	13.3	70.2	62.0	25.3	42.7	437
COLONIAL MANAGEMENT ASSC	655	719	47.6	n/a	n/a	37.8	42.7	438
CAMPBELL COWPERTHWAIT CO	95	130	n/a	42.6	n/a	n/a	42.6	439
RNC CAPITAL MANAGEMENT	145	391	27.8	36.2	47.6	59.0	42.6	440
ATLANTA CAPITAL MGMT CO	130	1137	29.9	55.3	n/a	n/a	42.6	441
DELAWARE MANAGEMENT CO	361	14230	41.4	43.7	n/a	n/a	42.6	442
PINNACLE ASSOCIATES LTD	164	322	37.8	60.5	35.0	36.7	42.5	443
PRUDENTIAL INS CO/AMER	1420	12147	33.8	41.8	49.1	45.2	42.4	444
UJB FINANCIAL CORP	89	127	n/a	38.0	40.2	48.0	42.1	445
PACIFIC FINL RESEARCH	61	1757	48.9	49.7	32.4	36.8	41.9	446
FIRST WACHOVIA CORP.	518	2635	18.1	15.7	116.5	17.4	41.9	447
OAK ASSOCS, SUB ADVISOR	18	14	n/a	n/a	n/a	41.9	41.9	448
COMMERCE CAPITAL MGMT.	64	64	40.5	43.0	n/a	n/a	41.8	449
NELSON BENSON & ZELLMER	85	321	38.4	n/a	n/a	45.0	41.7	450
MU-CANA INVT COUNSELLING	21	237	n/a	39.1	43.4	42.2	41.6	451
THORSON BROWN & PLUNKETT	111	141	48.1	46.5	33.9	37.6	41.5	452
KIRKPATRICK PETTIS SMITH	78	115	35.6	40.2	44.4	45.9	41.5	453
JENSWOLD KING & ASSOCS.	132	256	35.6	47.2	n/a	n/a	41.4	454
EATON VANCE MANAGEMENT	518	2098	49.6	31.1	35.5	49.4	41.4	455
REICH & TANG L.P.	66	1502	23.6	37.7	37.8	66.3	41.4	456
SCUDDER STEVENS & CLARK	563	4727	41.4	28.9	46.8	48.0	41.3	457
PENN SQUARE MUTUAL FUND	49	181	52.6	13.6	18.1	80.4	41.2	458
TWEEDY BROWNE CO. L.P.	83	635	41.4	48.2	30.6	44.2	41.1	459
CAMBIAR INVESTORS INC	83	212	35.4	32.0	61.4	35.2	41.0	460
BAYBANKS INVESTMENT MGMT	271	415	36.0	37.9	41.6	47.7	40.8	461
BANKAMERICA CORP	342	247	50.5	43.0	36.4	31.9	40.5	462
FIRST MANHATTAN CO	587	4428	44.4	41.9	48.0	27.1	40.3	463
DEAN WITTER REY INTERCAP	575	3205	41.5	39.2	n/a	n/a	40.3	464
KR CAPITAL ADVISORS INC	24	722	37.0	17.5	50.9	55.2	40.1	465
MARINE BANK/SPRINGFIELD	36	29	n/a	n/a	n/a	40.1	40.1	466
OLD KENT FINANCIAL CORP	379	886	42.6	49.0	40.3	28.2	40.0	467
FIRSTAR CORPORATION	425	1759	37.5	42.5	n/a	n/a	40.0	468
MERIDIAN MANAGEMENT CO.	63	254	22.9	15.9	65.9	54.9	39.9	469
WARBURG PINCUS COUNSELLR	337	2152	39.1	34.2	33.3	52.4	39.7	470

RELIANCE FINL SERVICES	20	665	33.7	9.0	77.9	38.0	39.7	471
STEPHENS INC.	31	155	17.3	41.9	35.0	64.3	39.6	472
GANZ CAPITAL MGMT INC	22	60	18.8	46.4	45.7	47.5	39.6	473
DELPHI MANAGEMENT INC.	94	550	38.5	39.3	36.0	44.6	39.6	474
GENERAL ELEC MED CARE TR	93	38	n/a	15.7	63.2	n/a	39.4	475
WESTSTAR BANK	31	23	51.8	26.9	n/a	n/a	39.4	476
MCORP	323	1134	40.6	n/a	n/a	37.3	38.9	477
IDS FUND MANAGEMENT LTD	25	53	12.6	65.2	n/a	n/a	38.9	478
ARNOLD INVT COUNSEL INC.	48	462	54.1	35.8	38.3	27.1	38.8	479
VAUGHAN NELSON SCARBORGH	53	211	30.1	47.5	n/a	n/a	38.8	480
GRAY SEIFERT & COMPANY	135	421	45.7	31.9	n/a	n/a	38.8	481
ORBON MUNN & COMPANY INC	55	97	31.1	46.2	n/a	n/a	38.7	482
CORINTHIAN CAPITAL CO.	23	54	16.9	42.0	14.9	80.6	38.6	483
FIRST EXECUTIVE CORP.	10	11	32.5	40.1	71.6	9.4	38.4	484
CONTINENTAL CAP. MGMT.	73	311	n/a	n/a	15.5	61.2	38.4	485
MERCHANTS NATL B&T/MUNCI	70	131	111.2	28.2	9.2	4.2	38.2	486
HANCOCK JOHN GLOBAL TRST	41	37	40.5	48.7	16.7	46.5	38.1	487
TUKMAN CAPITAL MGMT INC	12	375	n/a	n/a	34.1	42.0	38.0	488
DEL-VEST, INC.	77	135	23.6	n/a	n/a	52.4	38.0	489
CUTLER & COMPANY INC	25	592	59.9	19.0	9.3	63.7	38.0	490
MANAGEMENT ASSET CORP	97	392	15.8	27.4	30.4	78.3	38.0	491
YOUNG MEN CHRISTIAN ASSC	130	427	18.9	56.8	n/a	n/a	37.8	492
WISCONSIN INVESTMT BOARD	583	9670	41.3	35.1	33.1	41.5	37.7	493
FIDUCIARY-TRUST CO INTL.	582	4520	40.7	39.7	36.7	33.5	37.6	494
EIGHTEEN-38 INVT. ADVS.	200	1029	n/a	32.6	43.1	37.0	37.5	495
STAR BANC CORPORATION	266	179	35.4	n/a	n/a	39.6	37.5	496
NATIONWIDE FINANCIAL SVC	119	831	39.0	n/a	n/a	35.9	37.4	497
COOKE & BIELER INC	183	2291	51.3	24.7	29.4	44.0	37.3	498
BESSEMER TRUST CO/FLA	224	475	22.9	31.1	47.5	47.7	37.3	499
AETNA LIFE & CASUALTY CO	2377	4727	42.5	34.4	38.6	33.4	37.2	500
CAPITAL INTL. LIMITED	67	357	49.8	16.0	34.6	47.6	37.0	501
AMERICAN FUND ADVISORS	102	121	17.2	27.5	62.9	40.2	37.0	502
NATIONAL CITY BANK/AKRON	181	282	n/a	n/a	34.9	38.9	36.9	503
COHEN & STEERS CAP. MGMT	40	102	n/a	n/a	36.9	n/a	36.9	504
FIRST ALABAMA BKSHS INC	129	350	78.7	14.4	29.5	24.2	36.7	505
IDS INTERNATIONAL INC	21	53	14.9	58.4	n/a	n/a	36.7	506
WITTER, WILLIAM D INC.	106	340	22.8	32.1	47.2	44.6	36.6	507
COMMONWEALTH EDISON FUND	490	377	10.2	n/a	n/a	63.1	36.6	508
CRAMBLIT & CARNEY INC.	113	335	18.7	48.0	54.4	25.0	36.5	509
MARSHALL & ILSLEY CORP	268	1039	43.8	30.1	37.2	35.0	36.5	510
HEILWEIL HOLLANDER JACOB	85	39	40.4	37.2	36.1	32.3	36.5	511
BANKERS TRUST CO/IOWA	137	66	41.7	21.7	21.2	60.9	36.4	512
LEGG MASON INC.	118	724	33.0	36.2	43.8	31.9	36.2	513
BRITISH INVT TRUST PLC	26	42	32.2	40.0	n/a	n/a	36.1	514
UNUM CORPORATION	58	439	47.9	n/a	n/a	24.2	36.1	515
MANNING & NAPIER ADVISOR	156	2066	24.8	33.5	32.1	53.2	35.9	516
BREAU CAPITAL MGMT. INC.	76	106	31.1	47.9	37.4	27.0	35.9	517
CHEMICAL BANKING CORP.	981	9254	34.8	35.8	37.7	35.2	35.9	518
CONNECTICUT BK & TRUST	445	2036	62.2	23.0	30.4	27.8	35.8	519
FLEMINGS CAPITAL MGT INC	178	246	38.5	33.1	n/a	n/a	35.8	520
MILBANK WILSON WINTHROP	56	16	11.2	37.5	34.8	58.9	35.6	521
HUNTINGTON NATIONAL BANK	216	330	n/a	n/a	42.1	28.8	35.4	522
CIC ASSET MANAGEMENT	161	1328	35.3	30.6	43.4	32.2	35.4	523

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BURRIDGE GROUP INC.	88	203	22.2	32.1	46.4	40.3	35.3	524
PHILADELPHIA NATL BANK	288	1111	35.1	17.8	50.2	37.1	35.0	525
HARRIS ASSOCIATES, L.P.	350	2324	42.3	30.7	25.4	40.3	34.7	526
UNITED STATES TR/BOSTON	243	459	33.6	25.1	26.5	53.4	34.7	527
LIPMAN CARASSO&YOUNG INC	71	57	21.4	n/a	n/a	47.8	34.6	528
BAXTER FINANCIAL CORP.	38	97	n/a	n/a	n/a	34.5	34.5	529
FIRST PENNSYLVANIA CORP	755	3352	52.4	30.9	32.3	22.3	34.5	530
GABELLI FUNDS, INC.	152	554	27.1	35.8	36.8	37.4	34.3	531
PITCAIRN GROUP L P	83	425	13.9	38.3	41.4	43.2	34.2	532
CITIZENS & SOUTHERN CORP	412	2442	33.9	19.2	55.3	27.3	33.9	533
CHEMUNG CANAL TRUST CO.	85	108	41.5	24.0	34.9	34.8	33.8	534
HAWAIIAN TRUST CO LTD	462	1218	22.6	29.2	40.9	42.6	33.8	535
MIDLANTIC CORPORATION	446	1468	28.0	22.7	55.5	28.7	33.8	536
UNIVERSITY OF TEXAS SYS	559	1632	32.1	36.4	30.2	36.1	33.7	537
GARRISON KEOGH & CO INC	63	96	32.3	28.3	43.8	30.1	33.7	538
TORRAY, ROBERT E & CO.	87	621	65.2	28.6	16.5	24.3	33.6	539
LORD ABBETT & COMPANY	214	6281	32.4	31.4	39.3	31.4	33.6	540
OSTERWEIS CAPITAL MGMT	64	144	34.2	18.4	45.7	36.3	33.6	541
MORGAN J P & CO INC	1114	16901	30.5	34.1	29.4	40.5	33.6	542
NATL WESTMINSTER BK PLC	504	1541	33.4	33.6	n/a	n/a	33.5	543
OAK ASSOCIATES	70	206	n/a	n/a	31.4	35.5	33.4	544
HARTFORD FIRE INSURANCE	487	1125	25.3	n/a	n/a	41.5	33.4	545
AMOSKEAG BANK SHARES INC	105	79	n/a	33.4	n/a	n/a	33.4	546
PETERSON FLYNN&DINSMORE	111	209	28.2	33.3	32.4	38.4	33.1	547
BOSTON COMPANY INC	1416	9140	32.2	20.7	32.8	46.0	32.9	548
FIRST NATL BK&TR/TULSA	98	138	28.2	24.7	55.2	23.5	32.9	549
MIDWEST FINL INVT MGMT.	151	358	52.6	32.9	19.6	25.3	32.6	550
TEMPEST ISENHART CHAFEE	94	245	27.7	32.8	38.4	31.3	32.6	551
MARSHALL & SULLIVAN INC.	27	114	18.2	48.0	45.3	18.5	32.5	552
FISHER CAPITAL MGMT.	59	118	19.0	53.7	33.8	23.4	32.5	553
SEAFIRST CORPORATION	255	778	31.1	n/a	n/a	33.7	32.4	554
SHEARSON MANAGEMENT INC	45	182	29.3	21.9	32.6	45.6	32.4	555
FIRST HAWAIIAN BANK	107	347	22.6	40.6	43.1	23.0	32.3	556
ASHFIELD & COMPANY INC.	86	243	39.6	30.9	19.4	39.2	32.3	557
ARGUS INVESTMENT MGMT.	78	126	38.6	31.0	37.6	21.4	32.2	558
U S BANCORP	308	1086	32.9	n/a	n/a	31.4	32.2	559
GOFEN & GLOSSBERG INC	206	311	23.5	29.0	33.3	42.6	32.1	560
SOUTHTRUST BANK OF AL.	130	204	n/a	n/a	34.9	29.1	32.0	561
ENGEMANN ROGER & ASSOCS.	79	364	28.4	22.1	31.7	45.3	31.9	562
WRIGHT INVESTORS SERVICE	380	1607	28.5	34.2	22.7	41.8	31.8	563
OLYMPIC CAPITAL MGMT INC	79	773	35.2	22.1	41.9	27.7	31.7	564
CAPITAL INVT SVCS/AMER.	57	209	18.9	18.3	40.3	49.3	31.7	565
NATIONAL BK/COMMERCE TN	114	138	26.1	37.2	n/a	n/a	31.7	566
LA SALLE NATL BK/CHICAGO	1105	2166	n/a	n/a	30.9	32.2	31.6	567
BOWEN HANES & CO. INC.	102	393	37.3	25.7	n/a	n/a	31.5	568
OHIO CITIZENS BANK	215	336	23.2	30.3	34.9	37.1	31.3	569
HANSON INVT. MGMT. CO.	54	666	40.7	19.3	36.2	29.1	31.3	570
DREMAN VALUE MGMT. INC.	114	3439	22.6	30.3	41.0	n/a	31.3	571
MONTAG A & ASSOCS.	132	57	24.5	35.6	42.2	22.8	31.3	572
TOWNELEY CAPITAL MGMT	200	492	28.9	33.5	n/a	n/a	31.2	573
QUEST ADVISORY CORP	725	996	22.0	32.7	28.8	41.3	31.2	574
NORWEST BANK/MINNEAPOLIS	1017	2203	28.5	26.4	30.8	38.5	31.0	575
RUANE CUNNIFF & CO	141	1214	23.3	34.7	52.5	13.6	31.0	576

OHIO COMPANY	113	260	24.9	n/a	n/a	37.0	31.0	577
COMMERCIAL UNION INV MGT	48	173	31.0	n/a	n/a	n/a	31.0	578
BANK OF CALIFORNIA N A	1000	4841	34.2	33.1	27.5	29.0	31.0	579
FIRST EMPIRE STATE CORP	151	231	26.3	27.5	39.0	30.5	30.8	580
COMPOSITE RES. & MGMT.	46	162	n/a	n/a	35.4	26.1	30.7	581
FRANKLIN RESOURCES INC	359	2056	29.3	n/a	n/a	32.1	30.7	582
CRESTAR BANK N.A./DC	134	271	n/a	n/a	n/a	30.7	30.7	583
MILLER ANDERSON&SHERRERD	705	6916	25.8	28.4	28.1	40.5	30.7	584
RENBERG DANIEL H & ASSOC	120	73	35.3	22.8	30.5	33.8	30.6	585
ROTHSCHILD COMPANY	121	456	21.2	26.3	33.4	41.5	30.6	586
FIRST NATL BK/TOLEDO	202	204	26.1	18.1	39.4	38.6	30.6	587
SMITH, DONALD & CO., INC	28	718	45.2	20.8	13.7	42.1	30.5	588
INTEGRA FINANCIAL CORP.	204	1767	5.9	8.2	77.0	n/a	30.4	589
SASCO CAPITAL INC	30	906	25.6	37.1	34.4	24.5	30.4	590
BECK MACK & OLIVER	167	607	31.1	26.9	33.0	n/a	30.3	591
SHUFRO ROSE & EHRMAN	158	939	20.8	27.5	35.7	37.2	30.3	592
CENTRAL CAROLINA BK&TR	176	259	n/a	18.7	58.6	13.3	30.2	593
PRIMECAP MGMT COMPANY	118	2118	36.3	27.4	13.7	42.8	30.1	594
COMMERCE BANKSHARES INC	550	700	28.3	19.7	33.8	38.3	30.0	595
ONE VALLEY BANK N.A.	373	172	23.0	32.3	34.2	29.2	29.7	596
GARDNER & PRESTON MOSS	161	1059	35.2	29.0	25.5	29.1	29.7	597
FIRST TENNESSEE NATL CO	191	527	15.5	46.8	23.8	31.8	29.5	598
FIRST VERMONT BK & TRUST	127	100	n/a	n/a	31.5	27.4	29.4	599
SOVRAN FINANCIAL CORP.	477	2627	33.8	26.2	34.4	23.2	29.4	600
TEXAS AMERICAN INVT MGMT	204	408	35.5	28.2	25.9	27.1	29.2	601
BARROW HANLEY MEWHINNEY	72	6071	26.5	20.0	35.7	34.2	29.1	602
WILMINGTON CAPITAL MGMT	81	1128	42.0	16.1	n/a	n/a	29.0	603
WELLINGTON/THORNDIKE	1291	17897	17.5	27.9	29.4	41.2	29.0	604
BROWN ALEX INVT. MGMT.	162	723	21.6	35.4	39.2	19.1	28.9	605
GENERAL ACCIDENT INS	88	1875	29.8	29.9	28.3	27.1	28.8	606
MUTUAL LIFE INS CO N.Y.	245	531	17.3	15.7	25.2	56.2	28.6	607
CHESWICK INVESTMENT CO	49	169	40.1	16.2	32.7	25.3	28.6	608
CANE FALB STONE & CO INC	28	51	n/a	n/a	38.1	18.9	28.5	609
CALIF STATE TEACHERS RET	3511	11716	n/a	n/a	28.5	n/a	28.5	610
OHIO STATE TEACHERS RETM	209	4893	23.3	21.0	30.4	39.1	28.5	611
BANC ONE CORPORATION	682	2871	26.9	n/a	n/a	29.9	28.4	612
BANK OF TOKYO LTD	543	1139	21.9	18.2	45.8	27.1	28.2	613
KNIGHTS OF COLUMBUS	90	142	22.4	n/a	n/a	34.1	28.2	614
THOMPSON SIEGEL&WALMSLEY	112	1347	n/a	n/a	34.1	22.1	28.1	615
TRUST COMPANY OF GEORGIA	472	4703	24.5	23.8	37.5	26.2	28.0	616
PETROLEUM & RESOURCES	48	248	16.5	42.0	32.4	20.9	27.9	617
MERCANTILE BANK/MISSOURI	368	2427	23.4	20.3	36.7	31.3	27.9	618
FIRSTIER BANK NA/LINCOLN	98	162	21.2	16.9	26.0	47.2	27.8	619
LIBERTY NATL B&T/OKLA CT	80	292	17.3	19.1	47.6	27.1	27.8	620
UNITED JERSEY BANK	148	275	27.0	32.5	17.4	33.4	27.6	621
FIRST INTERSTATE BANCORP	1859	11907	29.0	29.5	24.4	27.3	27.5	622
LEYLEGIAN INVT MGMT INC	68	207	5.8	13.2	56.4	34.5	27.5	623
BLAIR WM & CO INVT MGMT	217	1410	30.8	21.4	29.4	28.4	27.5	624
MARSH & CUNNINGHAM INC	16	22	1.6	20.7	37.2	50.2	27.4	625
BERNSTEIN SANFORD C & CO	526	11739	n/a	15.9	28.3	36.8	27.0	626
AMCORE BANK N.A. ROCKFRD	100	107	18.1	27.8	27.7	34.0	26.9	627
RITTENHOUSE TRUST CO.	59	45	n/a	26.9	n/a	n/a	26.9	628
RAMPART INVT MGMT CO.	291	627	12.4	21.8	45.4	27.8	26.9	629

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DAUPHIN DEPOSIT BK & TR	241	440	22.2	43.4	18.4	23.3	26.8	630
MCCOWAN ASSOCIATES INC	68	1060	28.3	28.4	16.5	33.6	26.7	631
AMSOUTH BANCORPORATION	522	1599	10.1	24.1	53.1	19.2	26.6	632
HILLIARD JJB, LYONS WL	106	199	26.4	n/a	n/a	26.8	26.6	633
FIRST NH BANKS INC	137	176	21.7	25.3	26.2	33.1	26.6	634
INVESCO CAPITAL MGMT INC	329	10801	n/a	n/a	21.5	31.5	26.5	635
GLASS MANAGEMENT COMPANY	174	125	20.7	34.4	23.9	n/a	26.3	636
PAPP L ROY & ASSOCS.	82	234	30.3	31.4	17.6	25.9	26.3	637
VILAS-FISCHER ASSOCS.	94	77	21.7	30.8	n/a	n/a	26.3	638
GEOCAPITAL CORPORATION	104	671	29.6	29.0	23.8	22.1	26.1	639
FIRST CHICAGO CORP	427	1836	25.8	30.8	24.9	22.9	26.1	640
GROWTH STOCK OUTLOOK INC	90	83	20.9	24.7	30.1	28.5	26.1	641
ESTABROOK CAPITAL MGMT.	98	376	17.9	22.8	33.6	29.7	26.0	642
ADAMS EXPRESS CO	86	433	19.7	23.1	34.3	26.7	25.9	643
BABSON DAVID L & CO	836	847	38.4	29.2	19.0	17.0	25.9	644
HOTCHKIS AND WILEY	203	2956	n/a	25.9	n/a	n/a	25.9	645
MAHONING NATL/YOUNGSTOWN	124	140	17.2	34.4	16.0	35.8	25.8	646
ZELIFF, WALLACE ADVISORY	29	43	n/a	22.5	25.2	29.3	25.7	647
BOULEVARD BANK N.A.	181	230	15.2	n/a	n/a	35.3	25.2	648
DENT D F & COMPANY, INC.	55	146	13.4	24.7	35.6	27.1	25.2	649
UNITED BANKS OF COLORADO	347	2777	13.7	26.7	29.7	30.5	25.2	650
INVISTA CAPITAL MGMT INC	231	2696	24.2	n/a	n/a	26.0	25.1	651
DOMINION TRUST COMPANY	153	247	36.2	n/a	n/a	13.9	25.0	652
FIRST UNION CORPORATION	311	2884	23.8	26.2	n/a	n/a	25.0	653
FIRST FLORIDA BANK N.A.	227	1447	18.5	-13.6	16.1	51.2	24.8	654
FIREMANS FUND CORP.	96	2454	23.8	n/a	n/a	25.9	24.8	655
IC INVESTMENT MGMT. LTD.	76	491	12.9	19.1	27.3	39.3	24.7	656
HAVEN CAPITAL MANAGEMENT	88	315	26.4	20.8	29.2	22.0	24.6	657
CAPITAL GUARDIAN TRUST	367	10190	18.2	24.7	23.6	31.9	24.6	658
THIRD NATIONAL CORP	276	1030	24.6	n/a	n/a	n/a	24.6	659
AMERICAN NATL B&T/MUNCIE	123	209	n/a	n/a	26.3	22.7	24.5	660
FIRSTIER BANK, OMAHA	179	459	29.4	19.6	n/a	n/a	24.5	661
PNC FINANCIAL CORP	853	9798	35.9	16.0	22.4	23.0	24.3	662
KENTUCKY TEACHERS RETRM	85	865	43.7	12.1	17.8	23.3	24.2	663
STAR BANK N A,CINCINNATI	283	1079	17.8	n/a	n/a	30.3	24.0	664
TRUST SERVICES OF AMER	476	1017	25.9	n/a	n/a	22.1	24.0	665
HATHAWAY & ASSOCIATES	45	120	9.4	36.3	23.8	25.4	23.7	666
SEARS INVESTMENT MGMT	1317	4833	29.3	n/a	24.0	17.5	23.6	667
HOWE AND RUSLING INC	95	160	15.5	19.1	29.3	30.0	23.5	668
MULTIBANK FINANCIAL CORP	192	420	19.4	21.9	20.4	31.5	23.3	669
TALLASI MANAGEMENT CO.	50	220	24.6	19.1	26.3	n/a	23.3	670
FIRST MARYLAND BANCORP	172	354	20.5	16.3	23.7	32.0	23.1	671
MELLON BANK CORPORATION	3324	29009	26.3	18.9	26.3	20.9	23.1	672
WILKENS & NANOVIC ASSOC	59	305	18.0	32.2	20.8	20.6	22.9	673
ZURICH AMERICAN INSUR	53	160	n/a	22.9	n/a	n/a	22.9	674
NICHOLAS CO., INC.	193	1896	25.4	22.5	22.2	21.4	22.9	675
HAGLER MASTROVITA&HEWITT	91	1226	21.1	27.8	16.4	26.1	22.8	676
KEYCORP	356	810	22.7	21.2	24.5	n/a	22.8	677
GULF INVESTMENT MGMT.	93	301	16.0	30.0	28.9	16.3	22.8	678
HARRIS BANKCORP INC.	589	3922	23.0	22.5	n/a	n/a	22.8	679
BRISTOL JOHN W & CO	54	1601	7.1	23.1	33.9	26.8	22.7	680
BANK NEW ENGLAND CORP	598	2244	25.3	n/a	n/a	19.9	22.6	681
GRUMAN CORP. PENSION FD	125	775	30.8	18.8	21.5	19.2	22.5	682

AFFILIATED BKSH/COLORADO	160	261	20.0	13.3	36.6	20.2	22.5	683
EQUITABLE BANK, N.A.	192	303	14.3	30.6	n/a	n/a	22.5	684
PIONEERING MGMT CORP	494	6094	18.9	19.8	21.9	29.1	22.4	685
NBD BANCORP INC	506	4053	22.0	22.8	n/a	n/a	22.4	686
FIRST SEC BK&TR CO LEX	159	352	24.1	n/a	n/a	20.7	22.4	687
CNB, INC.	86	480	25.2	13.6	25.6	25.0	22.4	688
FIRST FIDELITY BANCORP.	658	4238	21.4	17.7	21.7	28.3	22.3	689
METROPOLITAN LIFE INSUR	624	2099	29.8	19.1	19.7	20.3	22.2	690
LINCOLN NATL BK & TR CO	90	155	22.1	n/a	n/a	n/a	22.1	691
MICHIGAN STATE TREASURER	503	7826	13.2	26.3	30.0	19.0	22.1	692
ALLEGHANY CORPORATION	275	939	13.2	11.6	17.5	45.4	21.9	693
CONNECTICUT NATL BANK	571	2976	n/a	n/a	21.9	n/a	21.9	694
LIBERTY NATL B&T/LOUISVL	233	599	20.6	23.1	n/a	n/a	21.8	695
RITTENHOUSE FINL. SVCS.	68	173	n/a	21.7	n/a	n/a	21.7	696
FIRST NATL BANK/PENNA.	104	136	16.9	18.7	25.4	25.3	21.6	697
SUMMIT TRUST COMPANY	148	291	14.2	18.8	31.7	n/a	21.6	698
BRUNDAGE STORY & ROSE	200	1259	28.4	14.9	20.4	22.2	21.5	699
NIAGARA SHARE CORP	49	132	3.6	27.1	21.9	33.0	21.4	700
BORG WARNER CORPORATION	47	215	23.8	22.3	17.3	22.1	21.4	701
FIRST KENTUCKY NATL CORP	266	1892	n/a	n/a	19.4	23.3	21.3	702
FIRST BANK SYSTEM INC	618	4618	13.6	29.5	20.3	21.8	21.3	703
BURNHAM, ROBERT W	56	65	21.6	17.1	20.6	24.8	21.0	704
UNITED MISSOURI BANK/K C	222	818	22.8	19.2	n/a	n/a	21.0	705
TRUSTCO BANK	50	56	19.7	17.7	27.6	19.0	21.0	706
CRAWFORD INVT COUNSEL	127	73	25.9	15.8	n/a	n/a	20.8	707
MICHIGAN NATIONAL BANK	152	347	24.3	17.2	n/a	n/a	20.8	708
DELAFIELD HARVEY TABELL	170	379	16.1	n/a	n/a	25.4	20.8	709
ROYAL LONDON MUTUAL INS	144	203	38.1	23.7	11.6	8.9	20.6	710
PAGE MILL ASSET MGMT.	88	304	20.3	n/a	n/a	n/a	20.3	711
SOCIETY CORPORATION	1069	2101	13.2	12.6	35.0	19.8	20.1	712
EVANS & MOXON CAP MGMT	34	173	2.9	16.1	1.3	60.2	20.1	713
MERCANTILE BANKSHARES CO	369	2056	9.9	25.4	32.7	12.2	20.1	714
ARGUS INVESTORS COUNSEL	56	612	22.8	21.7	17.4	17.9	20.0	715
NATIONAL CITY BK/CLEVELD	772	5544	20.3	19.3	21.2	18.4	19.8	716
CAPITAL RESEARCH & MGMT	313	14070	13.2	14.5	25.1	26.1	19.7	717
MCMORGAN & COMPANY	206	1799	20.0	18.7	n/a	n/a	19.4	718
OLD NATL BANCORP/EVANSVL	154	137	20.5	22.1	15.3	n/a	19.3	719
BANK SOUTH, N.A.	100	155	14.6	32.2	19.7	10.2	19.2	720
FINANCIAL INST. RETIRMNT	313	204	17.9	15.3	20.0	23.2	19.1	721
NORWEST BK/MINNESOTA NO.	237	113	22.2	9.7	14.3	30.0	19.1	722
ARKSTON INVESTMENT MGMT	64	332	18.4	19.6	22.9	14.6	18.9	723
FLIPPIN BRUCE & PORTER	59	173	17.4	18.1	15.0	24.8	18.8	724
FIRST SECURITY CORP/UTAH	289	810	n/a	n/a	14.7	22.9	18.8	725
MANUFACTURERS NATL CORP	1038	8146	19.0	19.4	10.3	26.0	18.7	726
TEMPLETON GALBRAITH&HANS	384	6767	n/a	n/a	19.6	17.6	18.6	727
BANK OF BOSTON CORP	662	4364	16.1	21.0	n/a	n/a	18.5	728
NBC BANK-SAN ANTONIO NA	107	119	19.1	n/a	n/a	17.9	18.5	729
MASS MUTUAL LIFE INSUR	138	1756	14.9	13.8	20.6	24.7	18.5	730
CAPSTONE ASSET MGMT. CO.	491	563	19.5	n/a	n/a	17.4	18.5	731
NATIONAL CITY CORP	72	78	n/a	n/a	14.0	22.5	18.3	732
FORD FOUNDATION	97	1482	23.6	12.9	n/a	n/a	18.2	733
MERCHANTS NATL BK/CED RP	47	49	22.9	17.7	19.3	12.9	18.2	734
FIRST CITY BANCORP/TEXAS	180	493	14.9	14.6	25.3	17.7	18.1	735

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IBM RETIREMENT PLAN	1115	4894	15.3	11.3	27.8	17.4	17.9	736
MUTUAL LIFE ASSUR. CDA.	53	443	n/a	21.5	15.2	16.6	17.8	737
ASSOCIATED BANC-CORP	276	313	22.8	18.0	14.9	14.5	17.6	738
FLEET/NORSTAR FINL GROUP	698	3228	17.2	n/a	n/a	17.5	17.3	739
WESTERN & SOUTHERN LIFE	100	525	10.8	n/a	n/a	23.8	17.3	740
INTEGRA INVESTMENT CO.	73	164	9.7	14.8	29.2	15.1	17.2	741
AMERICAN FAMILY MUTL INS	48	429	15.7	n/a	n/a	18.6	17.2	742
REPUBLIC NATL BANK/N.Y.	58	54	11.6	n/a	n/a	22.3	17.0	743
NORWEST CAP MGMT/NEBRSKA	362	146	12.1	16.7	20.6	17.4	16.7	744
NORTHERN TRUST CORP	946	6873	13.8	16.6	16.4	19.4	16.6	745
SECURITY NATL BK&TR/W VA	117	159	9.8	29.8	14.7	11.9	16.6	746
SHUMAN SCHNEIDER&HUTCHIN	49	132	17.3	23.5	13.7	11.4	16.5	747
WELCH & FORBES INC	212	820	19.2	9.5	16.5	20.6	16.4	748
BAROFIM FAYEZ	204	10226	10.6	19.1	17.8	17.9	16.4	749
RAY GERALD L & ASSOC.	170	174	17.5	15.1	n/a	n/a	16.3	750
BANKERS TRUST N Y CORP	3485	35441	10.7	18.3	14.5	21.0	16.1	751
UNIVERSITY OF DELAWARE	51	138	2.7	3.6	7.4	49.4	15.8	752
TRUSTEE & INVESTORS CO	144	537	4.6	38.9	10.6	9.0	15.8	753
DUFF & PHELPS INVT MGMT	168	2105	n/a	15.8	n/a	n/a	15.8	754
FARMERS GROUP INC	81	1664	9.4	15.8	12.4	25.4	15.7	755
CITIZENS 1ST NATL BK/NJ	87	104	n/a	n/a	n/a	15.7	15.7	756
MINEWORKERS PEN. SCHEME	110	338	14.5	17.0	n/a	n/a	15.7	757
SAFECO CORPORATION	258	1057	17.4	10.2	15.9	18.9	15.6	758
FIRST NATIONAL BK/OHIO	141	456	n/a	n/a	15.9	15.2	15.5	759
FIRST NATL BANK/OMAHA	72	283	12.8	n/a	n/a	17.2	15.0	760
BETHLEHEM STEEL PENS TR	93	855	24.0	9.4	12.1	14.0	14.9	761
MARYLAND STATE RETIRMENT	420	2110	n/a	n/a	11.1	18.5	14.8	762
UNION TRUST COMPANY/CONN	232	650	13.6	12.3	17.5	15.9	14.8	763
MANUFACTURERS HANOVER TR	583	4198	15.4	12.5	12.2	19.1	14.8	764
INB FINANCIAL CORP.	251	1003	n/a	15.6	13.9	n/a	14.8	765
RIGGS NATIONAL BANK/D C	429	651	9.7	n/a	19.2	15.1	14.7	766
NEVILLE RODIE & SHAW INC	146	200	8.7	15.3	19.0	15.2	14.5	767
DELAWARE TRUST COMPANY	202	647	13.8	14.9	n/a	n/a	14.4	768
WILMINGTON TRUST COMPANY	473	3798	12.4	17.6	14.2	12.8	14.3	769
BAKER FENTRESS & COMPANY	28	360	5.4	14.0	13.6	24.1	14.3	770
WHEELING DOLLAR BANK	178	449	n/a	n/a	11.6	16.8	14.2	771
GLENMEDE TRUST COMPANY	200	2635	n/a	n/a	n/a	14.2	14.2	772
EXXON CORPORATION	555	940	10.0	12.0	19.5	14.8	14.1	773
TEXAS TEACHER RETIRM SYS	378	8905	16.0	n/a	n/a	12.0	14.0	774
DIMENSIONAL FUND ADVS.	2545	3871	13.9	13.1	12.4	16.6	14.0	775
WELLS FARGO BANK N.A.	3674	42261	10.8	15.2	17.6	12.3	13.9	776
BRITISH COAL STAFF SUPER	111	343	13.0	14.4	n/a	n/a	13.7	777
WEST ONE BANK, IDAHO N A	54	348	20.0	n/a	n/a	7.3	13.7	778
VALLEY NATL BK/ARIZONA	252	598	11.1	13.9	12.1	16.9	13.5	779
CITY NATIONAL BANK/CALIF	57	81	16.9	n/a	n/a	9.8	13.4	780
NEW YORK ST COMMON RET.	810	19082	12.8	11.2	16.4	12.9	13.3	781
COLLEGE RETIRE EQUITIES	1445	28543	18.2	9.7	12.8	12.0	13.1	782
HOWARD HUGHES MED INST.	149	3065	12.1	3.7	22.8	13.7	13.1	783
TRANS WORLD AIRLS-RETIRE	126	372	24.4	13.6	10.7	3.0	12.9	784
AMERICAN INFO. TECH.	505	984	18.1	n/a	n/a	7.7	12.9	785
NEW YORK ST TEACHERS RET	674	12585	11.9	7.5	15.2	16.8	12.8	786
SANWA BANK CALIFORNIA	117	281	14.3	8.8	18.0	9.7	12.7	787
NATIONAL LIFE INSURANCE	161	654	11.4	7.7	15.6	15.4	12.5	788

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BOATMEN'S BANCSHARES INC	1228	7853	12.5	n/a	n/a	n/a	12.5	789
INTERNATIONAL INVESTORS	22	291	25.7	3.2	8.4	n/a	12.4	790
DODGE & COX	138	3810	n/a	9.9	16.9	10.4	12.4	791
PUTNAM TRUST CO/GREENWCH	139	313	n/a	n/a	7.6	16.8	12.2	792
ALLENDALE INSURANCE CO	79	214	9.3	15.1	n/a	n/a	12.2	793
STATE STREET BOSTON CORP	1035	15697	6.4	16.9	13.8	11.4	12.1	794
MERCHANTS NATL B&T/IND	321	1678	14.0	7.0	15.2	12.0	12.1	795
STATE FARM INVT MGMT	40	354	12.0	14.3	10.3	10.4	11.8	796
COGAN JOHN F JR, TRUSTEE	84	78	17.5	n/a	n/a	5.5	11.5	797
NATIONWIDE MUTUAL INSUR	173	1884	10.4	10.2	13.2	11.4	11.3	798
JEFFERSON NATIONAL BANK	100	158	6.0	12.7	16.7	9.8	11.3	799
NBD TRUST CO/ILLINOIS	230	223	7.6	n/a	n/a	14.8	11.2	800
E & CO., INC	97	197	n/a	n/a	n/a	11.1	11.1	801
AMERICAN NATL B&T/CHICAG	3380	9452	5.0	8.2	22.1	8.9	11.1	802
STATE FARM MUT AUTO INS	213	9324	13.4	9.7	13.0	8.2	11.1	803
FULLER ALFRED W.	52	90	3.1	13.1	16.8	10.8	10.9	804
SENTRY INVESTMENT MGMT	52	422	5.8	12.4	14.6	10.7	10.9	805
SHAW, GEORGE T.	63	120	9.0	8.5	14.5	n/a	10.7	806
OHIO SCHOOL EMP RETIRMNT	366	984	6.0	13.2	13.3	9.6	10.5	807
DOLLAR SAVINGS & TRUST	140	274	7.8	12.8	8.6	12.1	10.3	808
BANK OF NEW YORK	502	6047	10.0	n/a	n/a	10.7	10.3	809
STRATEGIC MANAGEMENT INC	15	22	8.1	6.8	2.4	22.4	10.0	810
FIRST NATL BK/S.W. OHIO	47	152	3.3	10.2	9.2	15.1	9.4	811
FIDUCIARY TRUST CO/MASS	245	847	6.6	8.4	9.9	12.4	9.3	812
U S STEEL & CARNEGIE PNS	209	5152	7.4	5.5	8.9	15.2	9.2	813
GENERAL ELEC INS PLAN TR	530	436	n/a	10.4	7.6	n/a	9.0	814
AMERITRUST COMPANY	620	5870	8.0	10.0	n/a	n/a	9.0	815
QUANTUM CHEMICAL CORP.	94	231	8.7	12.7	6.7	7.0	8.8	816
MACKENZIE FINANCIAL CORP	170	648	n/a	8.2	n/a	n/a	8.2	817
FORT WAYNE NATL BANK	148	343	8.1	9.0	6.9	7.8	7.9	818
UNITED STATES TRUST/N Y	650	4046	n/a	n/a	7.6	8.2	7.9	819
AMERICAN FINANCIAL CORP	28	2157	1.9	3.7	19.1	6.7	7.8	820
JEFFERSON PILOT CORP	144	731	9.7	8.0	8.2	4.5	7.6	821
DUKE ENDOWMENT	132	731	5.6	6.6	9.7	7.8	7.4	822
STATE MUTUAL LIFE ASSUR	78	366	8.5	6.0	6.2	n/a	6.9	823
NORWEST CAP MGMT/MONTANA	265	223	3.9	7.6	9.1	6.8	6.9	824
OLD PHOENIX NATL BK/OHIO	32	128	2.8	10.7	n/a	n/a	6.8	825
CITIZENS COMML & SVGS BK	86	206	6.5	5.3	n/a	n/a	5.9	826
UNIVERSITY OF CHICAGO	83	491	4.8	2.9	6.7	9.1	5.9	827
UNIVERSITY OF CALIFORNIA	76	9968	n/a	n/a	4.4	5.2	4.8	828
BELIN G D'ANDELOT	106	179	3.0	4.9	7.1	3.6	4.6	829
WADE JEPTHA H	79	86	4.7	n/a	n/a	4.2	4.4	830
WELLS FARGO INVT ADVS	489	1663	3.5	5.2	n/a	n/a	4.3	831
MEYER HANDELMAN COMPANY	167	481	5.4	3.8	3.3	4.1	4.1	832
RICE, WILLIAM MARSH UNIV	48	464	1.0	n/a	n/a	6.8	3.9	833
JOHNSON ROBERT WOOD FNDN	30	1403	5.6	n/a	n/a	2.0	3.8	834
CENTURY SHARES TRUST	28	124	n/a	4.5	0.6	4.7	3.3	835
LOEWS CORPORATION	14	5037	0.5	0.3	2.8	0.3	1.0	836
AMERICAN EXPRESS COMPANY	17	1505	0.3	0.3	0.3	0.1	0.3	837
Averages for 208 Bank Trust Depts.			23.0	27.5	28.5	27.7	26.7	
Averages for 65 Insurance Companies			35.3	28.2	36.0	36.2	33.9	
Averages for 54 Mutual Fund Managers			47.4	45.5	51.6	52.8	49.3	
Averages for 460 Investment Advisors			54.2	49.4	57.2	61.7	55.6	
Averages for 88 Other Managers			21.3	23.5	26.1	27.1	24.5	
Averages for All 875 13f Managers			37.9	37.2	41.9	43.8	40.2	

Source: Spectrum Data Base

Exhibit 18

Top 15 Funds with Investments in Indexed Equities
(as of September 30, 1988)

Fund	Indexed Equities $ Million	Total Equities $ Million	Total Assets $ Million	Indexed Equities as % of Total Equities	Indexed Equities as % of Total Assets
New York State & Local Common	12.60	17.55	37.92	71.79%	33.23%
New York State Teachers	9.52	9.80	22.78	97.14%	41.79%
California State Teachers	9.29	11.59	24.72	80.16%	37.58%
AT & T	8.77	15.78	28.69	55.58%	30.57%
New York City	7.65	12.79	35.54	59.81%	21.53%
NYNEX	4.11	6.53	11.26	62.94%	36.50%
California Public Employees	4.11	20.17	45.94	20.38%	8.95%
General E	3.70	9.70	21.10	38.14%	17.54%
Florida State Board	3.32	6.02	14.41	55.15%	23.04%
Teamsters; Central State	2.67	3.63	8.47	73.55%	31.52%
Ford Motor	2.50	8.60	15.10	29.07%	16.56%
Minesota State Board	2.39	3.49	9.66	68.48%	24.74%
Maryland State	1.81	2.78	8.71	65.11%	20.78%
Virginia Supplemental	1.74	4.26	8.04	40.85%	21.64%
Exxon	1.72	2.14	3.50	80.37%	49.14%

Source: Calculated from Data in Pensions & Investments Age Survey Pensions & Investments Age, January 23, 1989, with corrections by New York State and Local Common Fund

Senator DODD. I certainly want to thank her for the help she's given the Committee.

I want to say a few more words about the witnesses, when I get to the point of introduction. But, before then, Senator Shelby, if you have any opening comments, we'll take them at this point.

Senator SHELBY. Mr. Chairman, I want to commend you for holding this hearing. I have a written statement that I would like to be made part of the record.

I think this Committee you've called together today, the subject matter and the manner in which you've framed it, is very timely here in America and I look forward to hearing the testimony here today.

I want to take a moment, Mr. Chairman, to just commend the Chairman of Champion, who is here, for having the wisdom in making corporate decisions to invest $½ billion in my home State of Alabama. I hope he can find another $½ billion. [Laughter.]

I welcome him and everybody else here at the table today. It looks like he and his company are off to a tremendous start as far as corporate decision-making. [Laughter.]

Thank you.

[The complete prepared statement of Senator Shelby follows:]

STATEMENT BY SENATOR RICHARD SHELBY

Senator SHELBY. Mr. Chairman, first let me commend you for scheduling this hearing. I believe that the changing role of institutional investors in corporate governance issues is an extremely important subject and fundamental to many of the broader issues of corporate control. You have assembled a very knowledgeable and helpful panel of witnesses and I look forward to their testimony.

The past decade has brought with it a wave of corporate restructuring and in this period of time we have seen a significant change in investor attitudes. The focus is now on the short term and on the quick profit. Mr. Norman Augustine of Martin Marietta testified before this committee in July that the ownership of the equity in his corporation turns over every year, on the average.

This is a result of several factors. First of all, less and less of Martin Marietta is owned by individual investors and more and more of the company is owned by institutional investors, such as pension funds and mutual funds. The investment decisions are not made by the beneficial owners of these funds but by the fund managers, who focus on short term, quarterly gains rather than long term corporate strategy. This policy maximizes the short term return to the beneficial owners at the same time that it hamstrings corporate America's ability to make invest in research and product development that may not pay off for some years and many quarters down the road. This is an oblique contrast to corporate Japan, owned by webs of stable investors, thus giving management the luxury of being able to focus on long term development.

I am very interested in the increasing importance of the institutional investor and concerned that the integrity of the market is not corrupted by the growing influence of these large voting blocks. I am more familiar with the questions that the emerging strength of the pension funds and mutual funds brings up than I am the answers and I look forward to the testimony of these witnesses.

Thank you, Mr. Chairman.

Senator **Dodd**. Fine. Champion's corporate headquarters are located in Connecticut. [Laughter.]

Senator **Shelby**. That's why we're both here today. [Laughter.]

Senator **Dodd**. No, that's why he's here today. [Laughter.]

We've got to get this straight now.

Senator **Shelby**. And, Mr. Chairman——

Senator **Dodd**. Well Andy, I guess we can skip your introduction. [Laughter.]

We've asked everybody for brief opening remarks. Two minutes or less or so, if you could, and we want to run the hearing in a round table fashion.

Let me begin by introducing, of course, Andy.

Andy runs a major Fortune 200 corporation. Some of the other witnesses here could very well own your company or run your company before very long.

Robert Kirby, runs Capital Guardian Trust Company. Frank Borges is the Treasurer of the State of Connecticut.

Frank, I want to thank you for coming down as well. He is also here representing, in addition to his own capacity as Treasurer of the State of Connecticut, the Council for Institutional Investors, whose members hold over $300 billion in public pension fund assets.

Ned Regan, who is the Comptroller of the State of New York, directs almost $50 billion in pension fund assets on behalf of that State.

Ned, we thank you for being a part of this hearing this morning.

David Feldman runs AT&T's $40 billion pension fund.

We have two other experts with us today—Bevis Longstreth, who is a former Commissioner of the SEC; and Robert Monks, who formerly was administrator of the Pension and Welfare Benefit Programs of the Department of Labor.

Let me again welcome all of you and thank you for taking time out of very, very busy schedules to be a part of this hearing. It's a large subject matter and much has been written and discussed about this subject.

But, we hope this morning in a few hours to try to crystalize some of those issues and elicit from you your views and opinions about where we're headed and what ought to be done, both within the private sector and for those of us who sit at this side of the table from a public policy standpoint.

I think the issues are clearly unresolved as we look at them from a public policy standpoint. There's a great deal of interest in this subject matter and concern about where we're headed.

So, again, I thank all of you for taking the time out to be with us.

As I am saying those remarks, I see our colleague from Kansas. Senator, would you care to make any remarks?

OPENING STATEMENT OF SENATOR KASSEBAUM

Senator **Kassebaum**. Thank you, Mr. Chairman.

Just briefly, I very much appreciate the opportunity to hear from experts who are testifying on this subject. I would just like to note that, in a recent editorial in the Pension and Investment Age magazine, there was the comment that with the 70 percent or better annual turnover rate in the pension fund portfolios, that pension funds were acting more like speculators than investors.

This has been a concern that I have. I think that there are ways that it can be addressed that, hopefully, can be constructive. Perhaps not.

That's why I think this hearing is terribly important. The magazine further noted that pension fund returns are reduced as a result of the high transaction costs associated with the high turnover rate. This conclusion is supported by a Department of Labor report.

Further, a recent study of 13 filings found that the largest institutional investors on the average turned over in excess of 60 percent of all their portfolio assets every year, and that approximately 20 percent of the largest institutional investors turned over their entire portfolio assets each year.

I do not think such excessive churning and asset turnover is healthy for our economy. To the extent that one engages in such behavior, I think institutional investors should be discouraged from excessive and speculation.

I certainly look forward to hearing the expert testimony that we're about to receive.

Thank you, Mr. Chairman.

Senator DODD. Thank you very, very much.

I'll ask each one of you to give your statements in the order that I've introduced you.

Andy, we'll begin with you.

STATEMENT OF ANDREW C. SIGLER, CHAIRMAN, CHAMPION INTERNATIONAL, STANFORD, CT

Mr. SIGLER. Senator, thank you for inviting me today. I think, as you said, it's clear why I am here, although I've been testifying before this group for quite a number of years. I'm also representing the Business Roundtable. I'll try to make my comments from the perspective of a manager of a business and how I think this phenomenon affects us.

It's my position that the professionally-managed funds are the basic reason for the short-term outlook that is pressed on us. This money, as immense a pot as it is, is the fuel for the financing of those financial transactions that we are beginning to be concerned about.

I want to add one other thing. There are no bad guys in this situation. The system has changed dramatically, and it is the system that drives all the elements that are involved. Managers essentially run corporations the way the system sets the rules. That's why we're seeing things that I think are bad.

In your opening comments, you laid out how large this institutionally invested money is. It is now, from Champion's perspective, about 70 percent of our ownership and probably in the same proportion for other large corporations. We're looking at over $4 trillion.

Essentially one-half of that is pension money; 70 percent of that would be private, about 30 percent public funds. The remainder is mutual funds and some other parts of the business.

The basic problem starts from the fact that there is immense pressure on these fund managers to perform. They are so big, they *are* the market. So, in aggregate, they cannot beat the market, but they have to try.

They try by pursuing all sorts of things from junk bonds to LBOs to whatever. They are the major fuel for a lot of these deals. If we look at last year's results on the New York Stock Exchange, at least half of the gain was derived from the play on takeover speculation.

I'd like to add one other point. The pricing of a company's stock that's done by institutional owners is based on a short-term look at its earnings potential, having nothing to do with its basic underlying assets.

That differential between short-term earnings and underlying asset value is what all of the leveraged transactions work on, buying at the lower price because of the market, breaking up and selling the assets at their underlying value.

These fund managers are the group that's responsible for doing that and that's what makes those things work.

This change, and it's a change that's taken place in the last 15 years as these funds have grown, has really worked against the ability of a company to manage long-term.

Ultimately, I think it has had a very, very negative impact and if nothing is done will have a much greater impact on the economic system's competitiveness worldwide.

I think it raises the question is my job to satisfy the shareholder? That's something we learned in school. It became a truth.

But, today corporations run the economic system. For better or worse, that's the way it is. If you outline the kind of corporation that you want, one that does all the things that make the product competitive, it has to have the wherewithal to expand, to sell its product in world markets, to create jobs, to do all the things that are necessary to drive the economic system, yet all those things go against a cry from a shareholder that says: "Make money today. If you don't, we'll take you over and bust you up and take that money into our system."

As a manager, those are very contradictory pressures.

I think we have to look at the *responsibility* of ownership, not just the *rights* of ownership. As you said, Senator, in your opening comment—over half the pension money is corporate money. Champion itself has a billion dollars in our pension funds. That pales next to a few of the people down on my left. But, the aggregate of Champion's money with other corporations is very large. The corporate community is just as bad, maybe worse, in our pressures on people like the next speaker [Bob Kirby of Capital Guardian].

If you look at those numbers regarding turnover, you'll find them a lot worse in private pension funds, than you do public pension funds.

So corporations have an awful lot to do ourselves in terms of solving this problem. We're finally owning up to the fact that, in many respects, we're our own worst enemy.

There are a couple of myths that float around on this issue that I would like to make a quick comment on.

First, almost all of the pension programs we're talking about are classified as "defined benefit plans." That means that what a person gets in retirement is laid out, in effect, in a contractual relationship between the plan sponsor and the person.

What the fund accomplishes really doesn't accrue to the individual retiree. It really doesn't make that much difference because the amount in the fund is only required to cover those benefits necessary if you liquidate the fund today.

Meanwhile if you've got 20 years to go before you retire, you are really dependent upon the long-term viability of that company. That's the main point.

The second point, the amount of money in pension funds is the actuarial number derived from the promised benefits and the array of population within the plan. If funds do very well, plan sponsors stop contributing. If funds don't do well, e.g., the market goes down, they contribute more.

So, that number has not much to do with a fund's performance. It has to do with the basic plan. There's an ultimate irony here. We have money managers, at the direction of plan sponsors, working like mad to make short-term money that puts pressure on corporations to do all of those things for the short-term that hurts the long-term health of the company. Yet the only thing that's really important to those people who are 40 years old with their good benefit plan and their good retirement plan is the ability to be able to cash in when they're 62 or 65.

Their long-term security is dependent upon the long-term viability of this economic system and the particular company that they have a contract with. Those two forces are very much working against each other, and, in my opinion, have done damage to the competitiveness of our economic system.

[The complete prepared statement of Andrew C. Sigler follows:]

SUMMARY OF TESTIMONY
OF
ANDREW C. SIGLER, CHAIRMAN AND CEO,
CHAMPION INTERNATIONAL CORPORATION
BEFORE
SENATE SECURITIES SUBCOMMITTEE OF BANKING, HOUSING, AND URBAN AFFAIRS
ON
OCTOBER 3, 1989

I am here today to talk about the remarkable changes in the nature of corporate ownership and the impact of these changes not only upon corporate management but upon the entire economy.

Institutions today own 50 percent of the equity market as a whole, and in the case of large corporations like Champion, they own 75 to 80 percent. This enormous expansion in institutional ownership has resulted from the tremendous increase in pension fund assets -- $2 trillion and growing -- and from the increasing reliance of individuals on institutions such as mutual funds for their stock investments.

The aim of those who manage these funds is to out perform the average, but because together they comprise such a large part of the market, they have a hard time beating it. Result: they are looking for quick run-ups in stock prices and investments with high-yield returns. This leads them to chase takeovers and to invest in junk bonds and LBO funds. Pension funds alone directly purchase 15 percent of junk bonds, and insurance companies and mutual funds buy another 60 percent.

It's worth noting here that whatever gains pension funds make are not, for the most part, passed on to retirees. The great majority of retirees have "defined benefit" pension plans which guarantee them a certain monthly stipend regardless of how the fund fluctuates. If the U.S. economy as a whole does well, the pension funds will do fine.

All this frantic and speculative activity on the part of pension funds, therefore, does not benefit current or future retirees. Instead it may well put at risk the very companies which future retirees depend on for their pensions.

The dramatic change in corporate ownership from individuals to institutions currently works against the ability of companies to manage for the long-term. Where once we had patient investors interested in our long-term growth and development, today we are under constant pressure from institutional investors to boost the price of our company's stock and "provide immediate value to shareholders." They are hoping we will recapitalize, liquidate assets, buy back more of our stock and leverage up the company -- steps which make no sense whatever from the point of view of the long-term strength of this company but which boost the stock price short-term. Meanwhile, if I announce new capital expenditures, the price of our stock goes down. Where in all this is the incentive to keep American industry strong? In my view, it's absent.

These problems eventually raise the question -- who is entitled to the value in a company? Does it belong exclusively to shareholders? Or do corporate managers also have a responsibility to other constituencies for such things as the long-term growth and development of the company, for job stability, for pension security of current and future retirees, for the economic health of communities in which companies operate, to customers, suppliers, and, in fact, to the society at large?

I believe the institutions who are the new owners of corporate America must exercise their ownership responsibilities by weighing the impact of their investment decisions on the economy as a whole. They can no longer simply chase the quick buck at the expense of the long-term.

We in corporate America bear some responsibility for the current state of affairs. Half of all institutional funds are pension funds, two-thirds of which are in private plans sponsored by corporations. After the passage of the ERISA laws, we distanced ourselves from investment decisions. We now need to provide more guidance to our own pension fund managers.

For an in-depth discussion of these and related issues, I respectfully refer you to the attached paper prepared by Champion's Washington office for the Business Roundtable.

5/3/89

Background Paper Prepared for
The Business Roundtable
Task Force on Corporate Governance

THE ROLE OF PENSION FUNDS IN HOSTILE TAKEOVERS AND LEVERAGED BUYOUTS AND THEIR IMPACT ON THE U.S. ECONOMY

Summary

Probably no factor will benefit all Americans more than a robust and growing economy. Long-term planning and investment are essential to such growth, yet current economic pressures are directing our society to the pursuit of immediate, short-term gains, often to the detriment of long-term growth and development. This paper examines the role of pension funds and finds that their actions contribute, perhaps inadvertently, to this short-term perspective.

Pension funds are playing an ever increasing role in our country's economic system, both as the largest single owners of corporate America and as major investors in two funding mechanisms that fuel corporate takeovers -- junk bonds and leveraged buyout (LBO) funds.

Statistics indicate that most pension funds have a short-term investment orientation. This, in turn, increases the pressure on corporate managers to produce immediate results, leading to actions which can endanger our country's future global competitiveness.

Because of this enormous impact of pension fund investments on our economy, it is essential that we begin to examine the investment policies of pension funds and take steps to insure that the economic role they play is one that will foster long-term growth and development.

Background

Pension fund assets have reached a total of almost $2 trillion and are growing. Of that amount, approximately two-thirds are private pension funds which are governed by federal statute, the Employee Retirement Income Security Act (ERISA). These funds represent the assets of private pension plan sponsors which are invested to provide retirement benefits to employees in the private sector. The remaining one-third are public funds which are invested to provide retirement benefits for federal, state and local government employees. Public pension funds are governed by state statutory and common law, rather than ERISA, but the fiduciaries of such funds are usually held to similar standards of responsibility.

There are two general types of pension plans: the most prevalent is the defined benefit plan which promises a specific benefit upon retirement, usually based on a formula which considers years of service and average earnings. The second plan type is a defined contribution plan which promises a regular fixed contribution made to an employee's account. The employee's retirement benefit will depend upon the amount of the fixed contribution and the earnings gained thereon during the period of employment.

Under a defined benefit plan, the employer bears the investment risk and must make up for any shortfalls in investment performance in order to provide the promised benefit. The federal government also bears a certain amount of risk to the extent that these benefits are guaranteed by the Pension Benefit Guaranty Corporation. Under a defined contribution plan, the employee bears the investment risk since any increase in his or her benefit will be determined solely by the investment return on the contributions. According to the General Accounting Office, 86 percent of all active participants in pension plans have a defined benefit plan, while only 14 percent have a defined contribution plan.

Pension Funds as Corporate Owners

Pension funds are the single largest owners of the stock of America's publicly traded corporations. Ownership of stock by all institutional investors (insurance companies, mutual funds, trusts, pension funds, etc.) has been growing dramatically and pension funds constitute almost half of these institutional holdings. Fortune magazine recently estimated that pension funds own 25 percent of all corporate shares traded in U.S. markets, 50 percent of shares traded on the New York Stock Exchange, and 65 percent of the shares of companies included in the Standard & Poor's 500 Index.

Institutional holdings in individual corporations have increased as well. The Institutional Investor Project of the Center for Law and Economic Studies at Columbia University Law School reports that 47 out of the top 50 U.S. corporations ranked by 1987 stock market value had institutional ownership in excess of 33 percent; 41 out of 50 had over 41 percent; and 27 (more than half) had in excess of 50 percent institutional ownership. Numerous large corporations are reporting directly that between 70 and 80 percent of their stock is in institutional hands.

Because of institutional dominance of the capital markets (they virtually are the market), institutions have a hard time beating the market average. As a result, institutional investors are most likely to sell their shares for a premium in a hostile takeover situation and are very attracted to the high yields offered by junk bonds and LBOs.

Pension Funds As Investors in Junk Bonds and LBO Funds

Proponents of junk bonds and leveraged buyouts (LBOs) point to the fact that most pension funds direct only a small percentage of their assets to these high-risk investments (usually less than 5 percent) to justify the argument that such investments do not pose any unusual risk. While it is true that most pension funds are not endangering their current assets by such investments, the recent drop in junk bond prices and the looming recession do pose a threat to those funds with a higher percentage of these risky investments.

In addition, any gain resulting from an LBO investment could be more than offset if the pension fund had invested in the leveraged company's bonds. For example, one public pension fund saw its RJR Nabisco bonds devalued by $80 million as a result of the leveraged buyout by Kohlberg, Kravis and Roberts (KKR).

These arguments about the levels of risk incurred by individual funds, however, ignore the aggregate impact of pension fund investments in these high-risk vehicles. Pension funds in total are one of the largest investors in junk bonds and LBO funds. In 1988, according to the Congressional Research Service, pension funds directly purchased

15 percent of junk bonds (up from 10 percent in 1987), while insurance companies and mutual funds/money managers (each representing significant amounts of pension assets) purchased an additional 60 percent of junk bonds.

The capital pools and blind trusts used to finance LBOs, which are put together by investment houses such as KKR, Shearson, and Forstmann Little, are also made possible by the investment of large amounts of pension assets. A survey conducted by Pensions & Investment Age found that the top 200 public and private pension funds had invested $3.5 billion in LBOs in 1988. While the total value of LBOs in 1988 was almost $25 billion, approximately 35 percent or $8.75 billion of this was the so-called mezzanine financing.

Mezzanine financing refers to the layers of financing between the senior debt (generally raised through commercial banks) and the equity in the new company (usually 10 percent or less of the total capitalization). This financing entails a higher risk because it is subordinated to the senior debt. Most pension funds invest in LBO deals at the mezzanine level; thus, the $3.5 billion invested by just 200 pension funds most likely represents a significant proportion of the $8.75 billion in subordinated debt.

Without the funding mechanism of junk bonds and LBO funds, many of today's corporate takeovers would simply not be possible. Thus, pension funds play a second key role in fueling the takeover phenomenon, in addition to their willingness to sell to the highest bidder, by making these pools of financing capital easily available.

ERISA's Fiduciary Responsibility Requirements

Given pension funds' almost $2 trillion in assets, their large percentage of corporate ownership, and their role in financing takeovers, one begins to realize the enormity of the responsibility that has been placed in the hands of pension fund fiduciaries. In 1974 when ERISA was enacted, Congress was reacting to certain incidents of mismanagement and abuse which needed correction. Thus, the focus of ERISA was to assure that pension fund fiduciaries were acting to benefit the plan participants and not themselves or their superiors (i.e., the corporations or unions sponsoring the plans).

The reaction of corporate plan sponsors to the passage of ERISA was to try to insulate themselves from legal liability as much as possible. At the recommendation of counsel, the plan sponsors created several layers of responsibility (i.e., board committees, management committees, and independent investment advisors) between themselves and the actual decisions regarding the investment of the pension assets. As a result, hundreds of billions of corporate dollars are being invested today with top corporate management having little or no direct knowledge of, or control over, how those funds are being invested. And, while those money managers actually making the investment decisions occasionally claim the prerogatives of ownership, they really are only financial intermediaries.

Decisions on Whether to Tender in a Hostile Takeover

It wasn't until the mid 1980s that corporations began to realize the full impact of institutional ownership. Because the majority of publicly traded companies in America have a stock market value below the actual break-up value of their assets, would-be acquirers are able to offer a substantial premium over the market price in a hostile takeover. When pension funds with investments in the target company are faced with a decision on whether to remain with current corporate management in the hope that the company's stock will rise in value over the long-term, or to tender their shares to the hostile acquiror for an immediate and substantial gain, there is almost no question that a prudent money manager will go for the immediate gain.

While, historically, loyal individual investors and founding family members used to own controlling shares of corporations and have a personal interest in the future well-being of the company, this is not the concern of institutional investors today. In fact, many pension fund managers point to the ERISA fiduciary requirement that investments be made for the "exclusive purpose" of providing benefits to the plan participants and beneficiaries as not only justifying a decision to tender their shares in a hostile takeover, but as requiring them to do so.

Joint DOL and Treasury Release

Recently, the Department of Labor and the Treasury Department released a joint statement intended to clarify the duties of fiduciaries of pension plans under ERISA in a tender offer or hostile takeover situation. While pointing out that ERISA does not mandate that the plan fiduciary automatically tender the plan's shares in order to capture any premium over market represented by the tender offer, the release does conclude that such decisions must be based on what is in the economic interest of the pension plan.

As the Assistant Secretary of Labor for Pension and Welfare Benefits Administration noted, "plan fiduciaries are not required to take the 'quick buck' if they believe the plan can achieve a higher economic value by holding the shares than by tendering the shares and reinvesting the proceeds." The problem inherent in such an analysis, however, is that it requires a long-term perspective and pension funds are not generally long-term investors.

Turnover Rate of Pension Funds

One might think that pension funds could have a longer-term perspective that most other investors given the lengthy time horizon over which their liabilities accrue. Ideally, pension funds have the ability to be the "patient capital" that corporations need in order to plan for their long-term growth and development. Unfortunately, the statistics indicate that just the opposite is true.

Recent composite statistics from Northern Trust Company (a leading master trustee which, among other functions, acts as custodian for over $142 billion in pension assets) are typical of the industry. These figures indicate that, in the Northern Trust universe of pension plans, the annual turnover rate was 82 percent, 94 percent, and 63 percent, respectively, for 1986, 1987, and 1988 (the lower figure in 1988 is assumed to be the result of plans having moved significant assets from equities into cash after the October '87 crash). Thus, it appears that pension plans are selling the vast majority of their stock holdings within one year of purchase.

A recent editorial in Pensions & Investment Age (P&IA) noted that, based on the 70 percent or better turnover rate of many pension fund portfolios, pension funds were acting more like "speculators" than "investors".

Unfortunately, this short-term orientation has not increased the return on pension fund investments. Instead, according to P&IA, studies suggest that returns are reduced as a result of the high transaction costs associated with the high turnover rate.

Impact of Short-Term Pressures on Competitiveness

Because institutional investors are pressing for ever quicker returns to shareholders measured by stock price, corporate managers are too often driven to focus excessively on short-term performance to the detriment of the long-term best interests of the corporation and the economy as a whole. In today's takeover-driven securities markets, corporate managers engage in stock repurchases, recapitalizations and leveraged transactions resulting in higher debt in order to ward off hostile bids. Thus, whether a hostile takeover succeeds or not, funds vitally needed for long-term investments are diverted to debt reduction.

Fueled by institutional funds, the takeover/LBO game has become so fevered that it is resulting in the decapitalization of U.S. business through the substitution of debt for equity. Over the last five years, the debt of U.S. non-financial corporations has increased $840 billion, while equity has decreased nearly $300 billion.

In order to become, or to remain, strong global competitors, American corporations must be able to plan for long-term growth and development. This will require research into innovative technologies and capital investment projects with a long time horizon. It is important to remember that while research and development, and capital investment, do not produce immediate bottom line profits, they do produce other immediate benefits such as the creation of jobs and increased demand for goods and services. It is thus vital that sufficient capital remain available for such purposes.

The Interest of America's Workers

Pension funds are intended to protect the economic security of America's workers in their retirement years. No factor is more important in assuring such security than job stability. For example, an employee with pension coverage who works for one employer for 30 years will have a pension benefit upon retirement many times greater than the benefit of an employee with identical pension coverage who works for four or five different employers over the same 30 year period. This results from the fact that pension funds are intentionally devised so that employees do not accrue significant vested benefits in the early years of their employment.

There can be no better protection for employees' economic security than a healthy, growing economy. This, in turn, is dependent upon the long-term health and growth of the country's job producing corporations. However, the debt-laden corporations emerging from the takeover/LBO frenzy, with their attendant cutbacks, layoffs, asset sales, etc. cannot promise America's workers any type of long-term job stability.

In addition, the short-term gains earned by pension funds as a result of tendering for a takeover premium or investing in a high yield junk bond or LBO deal do not redound to the benefit of most plan participants. For the 86 percent of employees in defined benefit plans, their retirement benefit was determined by a fixed formula at the time of the plan's creation. Thus, if a pension fund earns a 25 percent return on an LBO deal, the retirement benefits of retirees are not increased; instead, the plan sponsor may be able to make lower contributions to the fund in future years. Conversely, of course, the plan sponsor must make increased contrubutions when necessary to compensate for pension fund investment losses or shortfalls.

The Interests of the Government and the Taxpayers

Pension funds, unlike most other investors, receive special treatment from the government because Congress and state legislatures view them as serving a vital public purpose. Among other benefits, contributions to approved funds can be made from pre-tax income, the earnings of the funds are not currently taxed, and the retirement benefits of ERISA pension funds are insured to a certain extent by the federal government through the Pension Benefit Guaranty Corporation (PBGC). The last point could be particularly important if a number of these highly leveraged companies failed in the next economic downturn and their pension responsibilities were taken over by the PBGC. As a result, U.S. taxpayers have a significant interest in how these funds are operated and how their assets are invested.

If pension funds are to continue to receive such unique and beneficial treatment, they should be required not only to protect the benefits of plan participants, but also to serve the broader public interest of promoting stable employment through economic prosperity. They must contribute positively to the goal of a healthy and growing economy.

Encouragement for Pension Funds to Invest Long-Term

The plan sponsors of ERISA pension funds have a responsibility to provide greater oversight and direction to the funds under their control. Pension fund managers often claim that their short-term orientation results from the pressures of corporate employers to show performance gains in a short time frame. For example, some fund managers have performance reviews as frequently as on a quarterly basis.

There are numerous steps that plan sponsors can take to encourage more long-term investing by their pension plans. Among others, these include providing long-term (3 to 5 year) contracts for fund managers, developing policy guidelines for such managers that stress long-term investments, and reviewing proxy votes and decisions on tender offers to determine if such actions are in the long-term best interests of plan participants.

Government sponsors of public pension funds should engage in similar activities. The state of New York has created a Task Force on Pension Funds to investigate these issues and report its recommendations to the Governor. Pending this report, a moratorium has been placed on the investment of New York state pension funds in LBOs. The recommendations of the New York Task Force may provide a model for other state activities in the near future.

Changes in ERISA Standards May Be Necessary

While numerous activities can be undertaken within the confines of current law to encourage pension funds to invest for the long-term, the ERISA fiduciary standards (and the related state statutory and common law rules) may ultimately be found to act as a barrier to fully accomplishing this goal. Despite the recent effort by the Treasury and Labor Departments to clarify that ERISA standards do not require pension funds to automatically seek short-term gains, it may be difficult to make substantial changes in the investment patterns of fund managers without broadening their legal charge.

One possible change would be to specify that fiduciaries must consider the long-term implications of their investment decisions and their potential impact on the future employment of the plan participants, including factors such as the long-term health and growth of the following: the plan sponsor, the industry in which the participants are employed, the region in which they live and work, and the economy as a whole. Additional study will be necessary to determine if such changes are, indeed, warranted.

Conclusion

At the time of their inception, it was reasonable and prudent for pension funds to focus primarily on increasing investment returns to assure that promised benefits would, in fact, be available when the participants retired. With the explosive growth of plan assets, however, over the 15 years since the creation of ERISA, and their growing impact on our economy, it is becoming apparent that pension funds must now take on additional responsibilities.

Given that pension funds are the largest single investors in our equity markets and thus play a key role in the allocation of capital, it is fair to impose on these funds an obligation to consider the impact of their actions on the economy as a whole and to act in a manner that will foster our country's economic prosperity. This obligation should not in any way reduce or substitute for their duty to protect plan participants, but should be an added requirement.

To accomplish this goal will require a cooperative effort on the part of government, plan sponsors, and investment managers to develop a plan for long-term investments that will promote employment, growth, productivity and competitiveness for America's future.

For Further Information, Contact:
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Senator **Dodd**. Thank you, Mr. Sigler, very much.

There will presumably be some arguments about those conclusions.

Mr. Kirby.

STATEMENT OF ROBERT G. KIRBY, CHAIRMAN, CAPITAL GUARDIAN TRUST CO., LOS ANGELES, CA

Mr. **Kirby**. Strangely, Mr. Sigler and I find much more with which we agree than disagree. One of the things that has for some time disturbed me greatly is the fact that over the past three or four decades in a sense our industrial infrastructure has become kind of onerous, partly because our corporations have gotten so large that the founding families have disappeared. And they are run by professional managers with no real significant ownership position.

Mr. Sigler may own $2-$3 million worth of his company's stock. But it represents a tenth of 1 percent or something of the total value of the company. So, all of a sudden, owners and managers are different parties. In the same three or four decades, the institutional investor has emerged, particularly in the public and private retirement system.

So that the case of 60 or 70 percent of many major U.S. companies being owned by institutions is true. And as Mrs. Kassebaum has pointed out, these guys regard long-term as maybe 15 months. Their turnover is 60 percent, and up to 70, 80 or 90 percent. Obviously, this is not a process I would call investment. It is essentially a trading mechanism; or so much pressure to perform has been introduced that investing has become more a popularity contest:

How do I identify what group is hot next week?

And where the corporate raiders are going to reappear? And what are the rumors of unfriendly tender offers, and all this junk?

Where that sort of thing is apt to occur.

But we've got this wonderful chicken and egg thing where professional money managers are under this intense pressure to produce good quarter to quarter numbers. Again, here, you can't paint all institutions with the same brush. Some out there have a very long-term point of view. Many have short.

But, I have to say, on average, a money manager probably is looking at about a 2 or 3 year time horizon when he is dealing with the typical middle developer, institution or client. When he gets hired, probably the main thing in his getting hired is his record over the past 36 months. When he gets fired, he can easily get fired with a bad record over 36 months.

I think most people managing companies would say you can't change the course of events in that short a time horizon. The market doesn't respond to favorable developments in companies in that short a time horizon. And as a net result, it's very hard to make a long-term commitment in a superior company because it may take a couple of years for what you see there to be reflected in the market price.

So, again, we come back toward this popularity contest kind of thing. But, when it comes to how you solve this, I frankly don't have the remotest idea.

One of the things that occurs to me as most significant is some kind of a graduated capital gains tax. If we're going to convert institutional investors from being traders to investors, I think there has to be some kind of a tax incentive, given that those people hold longer-term rather than short-term.

One of the questions here concerned the point of how should or do institutional investors help make corporate managers more accountable.

I think, on the contrary, they tend to do just the opposite because they're not shareholders very long. If you take the typical unfriendly takeover situation, you'll probably find that in a period of three or four days, maybe probably a majority of that company's stock is suddenly owned by arbitragers and speculators of every size, shape and kind.

And when it comes to exercising corporate democracy through shareholder votes, are you going to have these guys determine the fate of the company when most of them have probably held the stock for a week or less?

The problem is, as Mr. Sigler said, on many occasions, how do you find the owners of a company? They roll over so rapidly and there are no long-term investors out there.

I don't know how one does it, but it seems to me our system has to provide some incentives for long-term investors, and maybe some disincentives for short-term investors.

But the situation scares me to death the way it exists now. Any company in America—almost any—can be put in play overnight under present rules. And there's kind of no way to stop them.

Thank you.

[The complete prepared statement of Robert G. Kirby follows:]

Robert G. Kirby, Chairman
Capital Guardian Trust Company
SUMMARY OF TESTIMONY - WHOSE COMPANY IS IT?

UNITED STATES SENATE SUBCOMMITTEE ON SECURITIES HEARING
Tuesday, October 3, 1989

Two developments of great significance have taken place in the business segment of the U.S. society since the end of World War II. The first is the transition from founder/family management to professional management in most publicly-held U.S. companies. The second is the institutionalization of the capital allocation process through the rapid growth of public and private retirement funds and mutual funds supervised by professional investment managers.

Today we live in a wonderful world where huge corporations with market values of ten or twenty billion dollars or more are managed by professionals with no meaningful ownership positions. In turn, these shares are held, and their proxies voted by professional money managers running huge portfolios who have no ownership at all. Therefore, the question, "Whose Company is it Anyway?" - a critical question in the light of today's wave of corporate restructuring.

What are some of the shortcomings of (1) professional non-owner managements and (2) institutional investors? First, most top executives are in positions where the value of the company's stock that they own is insignificant in relation to their annual compensation, to their array of corporate perks, and to the power base that goes with controlling billions of dollars of assets and thousands of employees worldwide. The chief executive officer of a large multi-national company holds a position that rivals that of a sovereign ruler of a monarchy, or maybe the leader of an important religion. No wonder sociologists often refer to big company CEOs as America's new royalty. In short, the priorities of management may have limited overlap with the priorities of shareholders.

Second, professional money managers bear the responsibility for maintaining communication between publicly-held companies and their faceless actual owners. How do they discharge this function? They do it by brow-beating a management for a perceived short-coming in last quarter's earnings report, or by trying to trick management into disclosing what next quarter's earnings may be. They further comfort management by being in and out of the stock three or four times over a period of two years. Most are opportunistic and would encourage any hostile takeover that would increase the market price, no matter what its merits may be.

I have no hard statistics on the turnover rates in portfolios managed by institutional money managers. However, anecdotal evidence suggests that perhaps two-thirds of managers have annual turnover in excess of 50%. Probably one-quarter of managers have turnover of close to 100%. The situation certainly limits the hope of establishing a cooperative relationship between a publicly-owned company and its institutional shareholders. What point is there in trying to seek and to heed the advice and counsel of shareholders who will not be shareholders two or three quarters from now?

Share ownership doesn't seem to carry any responsibility. Corporate democracy has never really existed in the U.S. Proxy statements are incomprehensible to most individual investors. Institutional investors have for too long followed the time-honored custom of "voting with their feet" - meaning that when management undertakes something of which they disapprove, they don't oppose it, they simply sell the stock and move on to something else.

Somehow, we have to back away from today's "Buccaneer" capital markets. I am opposed to poison pills and their derivatives. However, I am also fearful that we have created a capital market environment in which the corporate raider can't lose. The LBO "vulture" funds now have over $20 billion of capital with which to leverage over $200 billion of buying power. Almost any company can be put "into play" with frightening ease. The great irony is that these LBO funds have been created with great help from corporate pension funds. It's like being attacked by your own watch dog. How could Marvin Davis have lost in his NWA takeover attempt? If he bought four percent of the stock before announcing the offer he already had a $50 million paper profit the minute the tender was announced.

I am afraid that many professional business managers and institutional investors have done a better job of looking out for their own interests than they have in living up to their responsibilities to society as a whole. The problem is the short-term time focus of everyone involved in the process. We need company managements that are more investor oriented. We need more money managers who are investors rather than traders and/or speculators.

Maybe we need some legislative help. I believe that a graduated capital gains tax is one of the most important things our legislators can do to stimulate long term investment. However, we should also consider a short term capital gains tax for tax-exempt investors. Congress did not provide tax exemption for pension and retirement funds so that they could engage in index arbitrage, computer-based day-trading strategies, monthly tactical asset allocation adjustments in the Chicago futures market and similar star wars kinds of activities. I would welcome a tax on short term profits of otherwise tax-exempt institutions.

As for "corporate raiders", what about recapturing the profit that a raider has made on the stock accumulated prior to his takeover announcement? It seems clear to me that the raider's knowledge that he intends to make a tender offer is indeed "inside information" in the truest sense. The people and institutions from whom he buys the stock prior to the offer announcement have been taken advantage of unfairly.

Finally, it seems to me we ought to worry about a tax system that encourages the replacement of real equity with a dangerous new ersatz kind of equity called junk bonds. I will readily acknowledge the wisdom of those who say that we may be dealing with something where the cure is worse than the disease, but I believe that the disease is potentially a very dangerous one.

No one knows the price of managing much of the country's industrial infrastructure by people constantly listening for footsteps ... or of managing the capital allocation process by people with a trading mentality. I suspect it could be very high.

Senator DODD. Thank you. On that positive note * * * [Laughter.] Frank, we thank you for coming.

STATEMENT OF FRANK BORGES, TREASURER, STATE OF CONNECTICUT, HARTFORD, CT, ON BEHALF OF THE COUNCIL FOR INSTITUTIONAL INVESTORS

Mr. BORGES. Good morning, Senator. Good morning, Members. It's my pleasure to be here this morning on behalf of both the State of Connecticut and the Council on Institutional Investors. It's also an opportunity to disagree with two very dear friends of mine—Bob Kirby, who happens to have been managing money for the State of Connecticut for over 10 years, and has done it very well, and Andy Sigler, who has a great company headquartered in the State of Connecticut.

Let me say at the outset that we in the State of Connecticut as well as the members of the Council of Institutional Investors are very proud of the position we've taken on several issues relating to corporate governance.

We've co-sponsored a variety of measures designed to assure that companies act responsibly. We have endeavored to utilize our influence to protect the interests of shareholders and make sure that shareholders 'earnings are not unfairly diluted.

Given the time constraints, I will not remark further relative to corporate governance Suffice it to say that the submission earlier has a fairly exhaustive discussion of the subject.

I would, however, like to turn my attention to what I find a very disturbing set of proposals that have been recently submitted—the tax on short-term capital gains of pension funds.

Most of these proposals have been offered according to proponents as a way to counter the alleged bias towards short-term speculation by institutional investors.

Such a proposal ignores the facts, which are that most pension funds are long-term and not short-term investors. Realize that all of us can quote statistics, and they may differ.

But I can submit to you, and I have submitted to you evidence that indicates that public pension fund-holders are indeed in the market for the long haul. We are, in fact, the market. If the market is unhealthy, we are unhealthy.

And those who would like to tax pension profits or use pension proceeds for non-pension purposes usually, I have found, have been investment banker types, corporate leaders who have given their case against institutional investors.

But I must respectfully submit that if they're truly concerned about the short-term profit orientation of the U.S. economy, that they really should look to the real origins of the problem, at least as we see it, mainly, the unbridled and excessive Wall Street profit motives.

And, often, I must say, corporate myopia. In my view, it is a disturbing corporate preference for near-term earnings at the expense of long-range investments that is the root cause of the United States' recent loss of global economic status. Both Wall Street speculators and manipulators in several short-sighted corporate entities have been active participants in the leveraged buy-out game that has plagued the U.S. economy throughout the 1980's. And history repeats itself.

All of us sitting around this table will eventually have to pay for these excesses. These activities have been designed to reward speculators and corporate managers and not long-term investors, such as public pension funds.

Most of the responsible pension fund managers I know of, including our own, just don't and won't participate in these investment opportunities; despite all the inducements to do otherwise, the managers of most pension funds I'm familiar with, including our own, continue to invest prudently and with a long-term view.

Pension funds do take short-term capital gains, and there is usually a good reason for them to do it. For example, when a prudent manager would consider selling his stock whose price was forced up by speculative excesses, but such sales are still the exception rather than the rule for most pension funds, precisely because they tend to take the longer view.

Similarly, some unexpected shifts in the fundamental outlook of a corporation might offer another valid reason for selling the firm's securities. If the shift would adversely affect either the stock's prices or earning potential or the corporation's status as a corporate citizen, this is where the issue of good, responsible corporate governance comes into play.

We would prefer shareholders to try to work with the corporate entity in question to change its outlook and practice in favor of one that better reflects our investment in philosophical goals.

It is for that reason, among others, that the funds I oversee and the funds of other members of the Council of Institutional Investors have been in the forefront of efforts to reach out to corporations and to governmental officials to achieve the kinds of long-term commitments, policies and levels of accountability that are all in our best interest.

I would ask you not to be swayed by those who would tax pension profits or use them for non-pension purposes.

In my view, to sacrifice the long-term health of the U.S. retirement system in order to solve problems caused by other activities or by poor planning or short-sightedness is entirely unacceptable. And I hope that, after reflection, that you will agree with me.

I certainly look forward to answering questions that you may have on the subject.

[The complete prepared statement of Fracisco L. Borges follows:]

State of Connecticut
OFFICE OF THE TREASURER

FRANCISCO L. BORGES
TREASURER

EDWARD J. FORAND JR.
DEPUTY TREASURER

Testimony

of

Francisco L. Borges

Treasurer

State of Connecticut

before the
Subcommittee on Securities

(Committee on Banking, Housing and Urban Affairs)
Dirksen Senate Office Building, Room 538

October 3, 1989, 9:30 a.m.

Subject

The Role of the Institutional Investors in

Corporate Governance and Capital Markets.

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TESTIMONY OF
FRANCISCO L. BORGES
TREASURER, STATE OF CONNECTICUT

Good morning, ladies and gentlemen. I am Francisco L. Borges, treasurer of the State of Connecticut, and fiduciary of a state pension fund portfolio of nearly $8 billion dollars.

I very much appreciate being given the opportunity to appear before you this morning, to share with you our state's perspective on the issues you are weighing, including corporate governance matters and the various recent proposals to tax pension fund profits and raid pension fund assets for non-pension uses.

Apropos of shareholder activism, let me tell you what my state has been doing. I am very proud of the fact that over the past two years, Connecticut has become very active in making its position known on such matters as confidential voting, fair employment practices and corporate governance.

Along with other major institutional investors, we have over the past year co-sponsored measures relating to three main issues:

the rescinding of poison pills (strategic moves by takeover-target companies to make their stock less attractive to potential acquirers); secret balloting by shareholders on corporate governance issues; and an end to religious discrimination in employment by subsidiaries of American companies doing business in the North of Ireland.

For example, we recently asked U.S. Air Group, Inc., at its annual meeting in Washington, D.C., to implement secret balloting by shareholders in the corporation.

I believe that Connecticut's Retirement and Trust Funds, with nearly $8 billion invested in equities, fixed income and real estate, have a significant and appropriate role to play in making certain that the companies whose securities we hold act in a socially responsible manner.

We are determined to use our clout to protect the interests of shareholders and make sure that shareholders' earnings are not unfairly diluted.

We oppose poison pills in general on the grounds that anti-takeover proposals by management are not usually in the best interests of shareholders.

Secret balloting by shareholders, similarly, is desirable because that way only the proxy tabulator and inspector of elections can learn the identity of the shareholder and how the shareholder voted on each issue. Such a voting system can prevent a company's management from putting undue pressure on a shareholder to change its vote on a particular issue.

Although we at the Treasury have not experienced much pressure from companies to change our vote, reliable sources indicate that many banks, insurance companies and private investment managers do. Shareholders can always disclose how they voted if they wish to -- indeed, the Treasury's votes are a matter of public record. But secret balloting is the heart of the American system of governance, and can only benefit the system of corporate governance as well.

In regard to our co-sponsorship of resolutions having to do with Northern Ireland, according to the British government's own Fair Employment Agency, Roman Catholics in Northern Ireland are still more than twice as likely to be unemployed as Protestants, and are often relegated to the most menial jobs and precluded from higher-paying skilled and managerial positions.

American parent companies are often not closely involved in the day-to-day operations of their Irish subsidiaries, and they may therefore be unaware of the implications of discriminatory employment practices in Northern Ireland. The Treasury's resolutions are a clear statement that it is high time American home offices intervened where necessary to guarantee full and equal employment opportunity for all Irish people.

I might add that this philosophy is very much a part of the view we took when we divested our pension portfolio of the securities of firms doing business in South Africa -- a process we completed July 1 of this year. Despite what critics and skeptics assert to the contrary, social responsibility in investing can only enhance pension funds' profitably, not the opposite.

I'd now like to turn my attention to the various proposals, including those sponsored by Sens. Kassebaum and Dole, to tax short-term capital gains of pension funds. Most of these proposals have been offered, according to their proponents, as a way to counter the alleged bias toward short-term speculation by institutional investors.

This, to my mind, is a transparent and misguided attempt to resolve the federal budget problem by tapping assets rightfully set aside to pay benefits to the retirees who depend on pension earnings for their very bread and butter.

And such proposals ignore the facts, which are that most pension funds are long-term -- not short-term -- investors. We, ladies and gentlemen, are in the markets for the long haul.

Those who want to tax pension profits, or use pension proceeds for non-pension purposes, usually enlist a cadre of investment bankers and corporate leaders to support their case against institutional investors.

But that is very much like plea bargaining. If they are truly concerned about the short-term profit orientation of the U.S. economy, they should look to the true origins of the problem -- namely, Wall Street greed and -- with all due respect -- corporate myopia.

In my view, it is the disturbing corporate preference for near-term earnings at the expense of long-range investments that is at the root causes of the United States' recent loss of economic status.

Both Wall Street speculators and several short-sighted corporate entities have been active participants in the leveraged buyout corporate takeover games that have plagued the U.S. economy throughout the greedy '80s. These games have been designed to reward speculators and corporate managers -- not long-term investors such as pension funds.

And most of the responsible pension fund managers I know of, including our own, just don't and won't play at these games.

Despite all the inducements to do otherwise, the managers of most pension funds, including our own at the State Treasury in Connecticut, continue to invest prudently and with a long-term view.

Sometimes, when the funds do take short-term capital gains, there is usually a good reason. Any prudent manager would look very hard at the possibility of selling a stock whose price was forced up by speculative excesses on the part of the company, for example -- but this is the exception rather than the rule for most pension funds, which tend to take the longer view.

Similarly, some unexpected shift in the fundamental outlook of a corporation might seem to offer another valid reason for selling the firm's securities -- if the shift would adversely affect either the stock's prices or earning potential, or the corporation's status as a good corporate citizen.

But this is where the issue of good corporate governance comes in. In that case, we would prefer as shareholders to try to work with the corporate entity to change its outlook or practice to one that would better reflect our investment and philosophical goals. It is for that reason among others that the funds I oversee -- and the funds of other members of the Council of Institutional Investors -- have been in the forefront of efforts to reach out to corporations and to government officials to achieve the kinds of long-term commitments, policies and levels of accountability that are in all of our best interests.

In short, taxation of a pension fund's short-term capital gains would adversely affect the fund in two ways -- first, an obvious charge against income from the tax, and second, the distortion of the investment decision-making process that would result. The net effect would be to reduce the availability of funds for retirement payments -- an outcome that to me and other public fiduciaries is entirely unacceptable.

In conclusion, I would ask you not to be swayed by those who would tax or raid pension fund profits. In my view, to sacrifice the long-term health of the U.S. retirement system in order to fund short-term projects -- necessary only because of mismanagement of the federal budget, with the resulting federal deficit, over the past eight or nine years -- is entirely unacceptable. A far better course of action, I believe, is to look at equity across the broad spectrum of taxation, which has been out of whack so long.

I hope, after reflection, you will agree with me.

Senator DODD. Thank you very much, Mr. Borges.

Mr. Longstreth.

STATEMENT OF BEVIS LONGSTRETH, PARTNER, DEBEVOISE AND PLIMPTON, NEW YORK, NY

Mr. LONGSTRETH. I appreciate your inviting me here to talk about these issues which I think are growing in importance. I commend the committee for seeking in this way to address them.

I see these lights going off.

Senator DODD. Just kind of keep an eye on them. I'm not going to hold you down.

Mr. LONGSTRETH. I can't miss them. [Laughter.]

Senator DODD. Well, it does keep you moving. [Laughter.]

Mr. LONGSTRETH. Well, compressing this into a sentence or two, the thesis I want to advance for your consideration is simply this:

Major changes in managerial control of U.S. public corporations and the nature of stock ownership in public corporations are occurring. And these changes are weakening managerial accountability to shareholders to the detriment of our corporate system of capitalism, and I think the nation's competitiveness and its economic well-being.

On the one hand changes in managerial control are giving management a tighter grip on the corporate reins, leaving shareholders less able to hold management to account.

But, on the other hand, changes in investment management techniques and practices are making exits easier, and the multiplicity of interests within the stock ownership group, creating diffusion and the potential for conflicts, are making shareholders less and less interested in holding management to account.

Together, these changes suggest a major shift in the point of balance between the competing claims of shareholders and managers to control the future of U.S. public corporations.

I agree with Andy Sigler when he says there are no bad guys in this situation. It's simply that there are forces at work that are triggered by highly-understandable needs and human reactions. But together, these shifts with respect to managerial control on the one hand and stock ownership on the other are threatening to work a real change in the system we have known.

The Berle and Means thesis of separation of ownership and control of the corporation is of course well-known. The major challenge that this separation created in 1932 and since has been to try to align the interests of managers with those of the shareholders because the separation of ownership and control meant that there was a possibility that those interests would diverge in some areas.

To address this concern has been the great challenge of corporate law. It has been done through various policing mechanisms such as liability rules, shareholder consent and, basically, market forces, including the market for managers and the market for control of the corporation. These mechanisms are being eroded by the changes I refer to.

My written testimony, which I request be included, outlines in some detail what these changes are. But they include—I just emphasize a couple on the managerial side—they include a straining of the business judgment rule to make it apply to situations where it was never intended to apply.

They include the adoption in at least 25 States of the so-called multi-constituency law, which has either as its express purpose or implicit purpose to change the orthodoxy by which our corporations have functioned for at least 100 years, that being the alignment of the manager's fiduciary duty with the shareholder and not with a large number of other constituencies that need to be served, and can be served, but in other ways.

And they include the anti-takeover laws in at least 25 States.

Now, turning to the stock ownership side, the changes include, as we've heard, continued growth in institutional ownership. They include a separation of ownership of stock from control over the stock. And that's been mentioned. In other words, a parallel Berle, Means kind of separation on the stock side, which creates a separation between the beneficial owner and the power to use the tools of ownership in a productive way, powers held now by intermediaries.

They include indexing which, by the way, is a reflection of a long-term investor, so long-term that he doesn't want to try to make specific decisions. And there's over $200 billion in indexing now and it's a phenomenon that's growing.

There are the derivative products that facilitate exits and entries into the market. And there is the rise of asset allocation. We are in an age of the primacy of the asset allocation decisions, decisions with respect to classes of assets and markets around the world, which are attracting more and more management time and effort to the subordination of picking stocks.

There is the voicelessness that has been referred to of the institutional investors with respect to public corporations. It's by choice and also by necessity because of the problems of cost involved in trying to be a voice with respect to a public corporation, free rider problems, problems of collective action and the like.

And, finally, there are some suggestions of late that really we ought to change the fiduciary standards of investment behavior so as to have kind of a multi-constituency duty creep in to what has been a very strong alignment of the interests of money managers with those they serve, the beneficiaries.

So, all there changes are detailed in my written statement, and they pose problems. I think these problems create a serious issue for Congress because states around the country have demonstrated an inability to think globally. Let's put it that way. And a demonstrated ability to think about their own interests within the state, which is very important. And looking through that lens, everything they've done is understandable.

But, looking globally, it isn't useful, some of these steps that have been taken aren't useful.

Senator **Dodd**. Why would you expect them to when we don't do it in the Congress? [Laughter.]

Mr. **Longstreth**. Well, now wait a minute. They are serving their constituency and serving it well. If the Congress would serve its constituency and serve it well * * * [Laughter.]

Anyway, I think the importance of this issue is magnified by the globalization of the marketplace and the fact that we are going to be competing in our system with many others which are differently oriented and differently run. And the SEC's recent actions involving Reg S and 144A are going to ease the ability of U.S. investors and foreign investors to fight each other.

Senator **Dodd**. There are some other questions that those issues raise as well, but I appreciate your comments. I'll get back to you.

Those lights are as much for us as for you. Verbosity is more commonplace on this side.

Mr. **Longstreth**. I actually had a solution, at least in principle, to the problems I've addressed.

Senator **Dodd**. No, go ahead. I'll back up. [Laughter.]

We're not like that around here. [Laughter.]

Mr. **Longstreth**. Well, I have come back from working in London with the Takeover Panel and the rules that operate over there. And maybe it's just recent experience that diverts my mind, but I am very impressed with the British system. And that system is based upon the imperative that shareholders should be given a chance to evaluate and vote on a bid for a company's shares.

And the system operates to prevent the management of the corporation from frustrating the bid unless they go out and get shareholder consent. It requires an offer for all shares when a person hits the 30 percent level. And it requires disclosure. And, importantly, there is a limited time during which the corporation can be under what they call "siege"—the siege of a hostile bid, because they recognize that sieges aren't good for long-term planning.

I think that the actions that are being taken and threaten to continue to be taken at the state level are such as to undermine the basic entrepreneurial system that we have unless we do something about it.

All these steps are being taken for perfectly understandable reasons, but they are bending our basic alignment of interest of management with interest of share holders; they threaten to bend this basic corporate authority out of shape, I think, to the overall detriment of our competitive engine.

So, unless the British system is too simple for us, a less legalistic and more straightfoward system, or it represents has a great deal to commend itself.

So that's the principle I was espousing.

[The complete prepared statement of Bevis Longstreth follows:]

October 2, 1989

Summary of
Statement of Bevis Longstreth
Before the Subcommittee on Securities of the
Senate Banking Committee
October 3, 1989

I welcome the invitation to give testimony on the issue of corporate governance in the context of takeovers and other changes in the financial marketplace, and particularly with reference to our country's publicly-held corporations, in whose stock there is national and, increasingly, international interest among investors the world around.

The thesis I want to advance for your consideration is this: major changes in managerial control and the nature of stock ownership of public corporations are occurring that weaken managerial accountability to shareholders to the detriment of our corporate system of capitalism and the nation's competitiveness and economic well-being.

On the one hand, changes in managerial control are giving management a tighter grip on the corporate reins, leaving shareholders less able to hold management to account. On the other hand, changes in investment management techniques and products, making exits easier, and the multiplicity of interests within the "ownership" group, creating diffusion and the potential for conflicts, are making shareholders less and less interested in holding management to account. Together these changes suggest a major shift in the point of balance between the competing claims of shareholders and managers to control the future of U.S. public corporations.

Since 1932, when Berle and Means published The Modern Corporation and Private Property, the central characteristic of the public corporation has been the separation of ownership and control. Managers didn't need capital to be good managers. As a consequence, the growth in a professional class of managers resulted in those controlling the corporation owning only token holdings in its shares. With the separation of ownership from control came risks of conflict between the interests of shareholders and the interests of managers over the control and use of corporate assets. The need arose to devise a system that allowed managers discretion enough to run the corporation well while assuring it was also run in the best interests of shareholders.

It has been the great challenge of corporate ordering to meet this need -- to control "agency costs" by constraining managerial abuse of discretion. There are basically three ways by which corporate law seeks to meet this challenge:

1. through liability rules (for breach of the duties of care and of loyalty);
2. through shareholder consent; and
3. through market forces (e.g., the market for products and services, the market for managers and the market for control).

These mechanisms rest on the basic economic theory that the business corporation should be managed in the sole interest of its shareholders and the legal corrollary that the overriding fiduciary duty of managers is to administer corporate resources for the benefit of its shareholders. It's important to keep in mind that the paradigm of the public corporation to which these policing mechanisms apply is one with widely dispersed public ownership of shares, token ownership by corporate managers and a board of directors composed of senior executives and outsiders selected by them.

The changes in corporate America that I'm talking about, and which weaken all three of these policing mechanisms, are revealed by looking at what has happened to, on the one hand, managerial control and, on the other hand, stock ownership since 1932, when Berle and Means observed that a separation had occurred between the two. (The testimony will detail these changes.)

The problems created by these changes are likely to be exacerbated as the globalizing tendencies of finance cast our system of corporate governance up against those of other centers of finance around the world. Performance of U.S. corporations in recent decades suggests the need for some modesty about our highly legalistic system. The other major systems of corporate governance mentioned earlier rely much more on control derived from the substantial ownership of a few institutional investors, particularly the banks, and a substantial creditor role: in short, there exists in these systems a close connection between the size of one's investment and the strength of one's voice.

If the thesis argued above is correct, serious attention to these fundamental changes, and their probable impacts on corporate accountability, is warranted. This matter deserves attention from the SEC and the Congress as well as from business leaders, investment professionals and the Bar.

It is my recommendation that Congress come to the rescue of such important, time honored and useful notions as the business judgment rule for corporate behavior, the prudent person rule for the management of other people's money and the public corporation as a trusted and reliable vehicle for attracting and holding the equity capital of non-controlling investors. At the state level, the wide variety of efforts to protect management from hostile takeover bids may be warranted if looked at in isolation, from a state perspective. However, these efforts are generating change and pressure for further change that entail mistreatment of these basic rules of corporate and investment behavior, to the ultimate detriment of the public corporation and the public interest.

What Congress should do in principle may be readily stated. It should add rules to the Williams Act that accord to shareholders of a public corporation the right to consider a bid for its shares, free of any act by management that frustrates that right unless the act has been consented to by a majority of shareholders.

Bevis Longstreth
October 2, 1989

STATEMENT OF BEVIS LONGSTRETH
BEFORE THE
SUBCOMMITTEE ON SECURITIES OF THE
SENATE BANKING COMMITTEE

October 3, 1989

October 2, 1989

Statement of Bevis Longstreth
Before the Subcommittee on Securities of the Senate Banking Committee
October 3, 1989

Chairman Dodd and Members of the Subcommittee:

Introduction

I welcome the invitation to give testimony on the issue of corporate governance in the context of takeovers and other changes in the financial marketplace, and particularly with reference to our country's publicly-held corporations, in whose stock there is national and, increasingly, international interest among investors the world around.

The thesis I want to advance for your consideration is this: major changes in managerial control and the nature of stock ownership of public corporations are occurring that weaken managerial accountability to shareholders to the detriment of our corporate system of capitalism and the nation's competitiveness and economic well-being.

On the one hand, changes in managerial control are giving management a tighter grip on the corporate reins, leaving shareholders less able to hold management to account. On the other hand, changes in the nature of stock ownership are causing shareholders to be less interested in holding management to account. Together these changes suggest a major shift in the point of balance between the competing claims of shareholders and managers to control the future of U.S. public corporations.

Thesis

Since 1932, when Berle and Means published The Modern Corporation and Private Property, the central characteristic of the public corporation has been the separation of ownership and control. Managers didn't need capital to be good managers. As a consequence, the growth in a professional class of managers resulted in those controlling the corporation owning only token holdings in its shares. With the separation of ownership from control came risks of conflict between the interests of shareholders and the interests of managers over the control and use of corporate assets. The need arose to devise a system that allowed managers discretion enough to run the corporation well while assuring it was also run in the best interests of shareholders.

It has been the great challenge of corporate ordering to meet this need -- to control "agency costs" by constraining managerial abuse of discretion. There are basically three ways by which corporate law seeks to meet this challenge:

1. through liability rules (for breach of the duties of care and of loyalty);
2. through shareholder consent; and
3. through market forces (e.g., the market for products and services, the market for managers and the market for control).

These mechanisms rest on the basic economic theory that the business corporation should be managed in the sole interest of its shareholders and the legal corollary that the overriding fiduciary duty of managers is to administer corporate resources for the benefit of its shareholders. It's important to keep in mind that the paradigm of the public corporation to which these policing mechanisms apply is one with widely dispersed public ownership of shares, token ownership by corporate managers and a board of directors composed of senior executives and outsiders selected by them.

The changes in corporate America that I'm talking about, and which weaken all three of these policing mechanisms, are revealed by looking at what has happened to, on the one hand, managerial control and, on the other hand, stock ownership since 1932, when Berle and

Means observed that a separation had occurred between the two.

Managerial Control

Although 1988 and 1989 have been heralded by some as the years in which the shareholder found its voice, I'm dubious. Since 1932, and particularly recently, changes have occurred giving management increasing levels of control -- a tighter grip on the reins of the corporation. Here's why:

Elimination of Liability. Delaware and other states have approved an elimination of liability for breach of the duty of care (but only with shareholder consent and with some important limitations), and institutional investors have widely supported this change in corporate charters.

State Anti-Takeover Laws. Since the Edgar v. MITE Corp. decision in which the Supreme Court in 1982 invalidated an Illinois anti-takeover law on commerce clause grounds, at least 29 states have adopted second generation anti-takeover laws, designed to avoid direct conflict with the Williams Act by regulating corporate rights and powers typically defined by state law. One approach defines shareholder voting rights to, for example, deny a hostile bidder with a minimum accumulation the right to vote unless approved by a majority of disinterested shares. Another approach regulates business combinations by, for example, blocking a hostile bidder who acquired control the right to complete a business combination for a period of years unless approved, in advance of the bid, by the target's board of directors.

The Supreme Court in CTS Corp. v. Dynamics Corp. of America, decided in 1987, approved the shareholder voting approach and lower courts seem to be approving the business combination approach.

Poison Pill. The adoption by boards of directors of poison pills have been widely approved by the courts, despite the perception that they have adverse effects on shareholders, as evidenced by directors' unwillingness to seek shareholder approval (some 400 corporations have adopted them without consulting shareholders).

Non- or Limited Voting Common. Until the SEC adopted Rule 19c-4 to limit the practice, there had been a growing use of two classes of common stock, one with non-voting or limited voting rights for the public shareholders and the other with disproportionately large voting rights for management and allies. This technique affords a method of perfecting control in management even against the most vigorous hostile offer.

Proxy Contests. Proxy contests have proved difficult to win against incumbents, even where a large percentage of the shares are in the hands of institutional investors and economic interest would suggest that shareholders ought to favor the challengers. Recent examples of proxy contests lost by insurgents making premium bids include: Conniston against Gillette; Icahn against Texaco; Bank of New York against Irving; and Batus against Farmers Group.

Erosion of Market Forces. Market forces have been eroded as a check on management. Despite a powerful belief by many (but by no means all) that (to quote Professor Robert Clark of Harvard Law School) "takeovers via stock ownership are the most effective form of corporate accountability," the effectiveness of this tool has been eroded. The most significant reasons for this slippage are (a) a contrived application of the business judgment rule to takeover situations and (b) the emergence of state laws permitting directors to consider non-shareholder constituencies as a basis for taking action.

(a) Expansion of the Business Judgment Rule. Generally speaking, courts have permitted the business judgment rule to apply in change of control situations, especially when independent directors approve of the defensive action taken. Except where the directors act so as to put the corporation up for sale (at which point the Revlon v. McAndrews & Forbes duty to become an auctioneer is triggered), the business judgment rule has been used successfully to protect directors in a wide range of defensive maneuvers taken without the consent of shareholders, including, of course, the adoption of poison pills, but also:

-- the use by Polaroid, to defeat Shamrock's all cash bid, of a capital restructuring plan and transfer to an ESOP and a friendly investor of sufficient votes to block the Shamrock bid; and

-- the use by Time, to defeat Paramount's all cash bid, of a poison pill coupled with its own all cash bid for Warner, despite the much lower value to Time shareholders of the Time-Warner enterprise ($125 per share) than the Paramount bid ($175 per share initially; then $200), other corporate disadvantages of the Time bid and the fact that the original plan of Time and

Warner for a stock for stock merger had been recast to avoid a shareholder vote.

These cases, and their outcomes, highlight the difficulty that Delaware courts will have in applying the so-called proportionality test first announced in Unocal v. Mesa Petroleum. Under this standard, which was designed to address the danger that a board of directors may implement anti-takeover measures primarily in its own interests, directors have the burden of proving first, that they had reasonable grounds for believing there was a danger to corporate policy and effectiveness (this burden being met by a showing of good faith and reasonable investigation), and second, that the responsive action taken was reasonable in relation to the threat posed.

It remains to be seen to what extent the Delaware courts are able to apply the "proportionality" standard in a meaningful, substantive way. The outcomes in Polaroid and Time-Warner are not very hopeful signs, since in each the defensive response appeared pre-emptive in denying shareholders a choice.

The problem is that a very complicated standard of review has been developed to try to support the application of the business judgment rule to situations for which it was never designed. It was not intended to bear the weight of the conflicts that emerge from change of ownership and control situations. While the rule works well for ordinary business transactions, it does not appear to work at all when the potential conflict between duty to self and friends and duty to shareholders becomes acute.

In theory the actions of a committee of non-employee directors ought to remove the conflict sufficiently to permit the business judgment rule to apply. However, in practice a powerful structural bias is observed. Outside directors are typically chosen by management not alone for their wisdom and experience, but for their willingness to provide support and loyalty to management when the going gets tough. Within the permissible limits of the law, it is reasonable to assume that an outside director's instinct for loyalty will powerfully affect the ways in which his wisdom and experience are applied. In cases where corporate ownership or control is being challenged, if one is inclined to support management, it will almost always be possible to find some justification for opposing the hostile bid. And beyond the tugs of loyalty, there is the director's own position, which, even more than management, is likely to be lost if ownership or control changes hands.

(b) Multi-Constituency Laws. There has been a rapid growth in the multi-constituency idea, by which state corporate laws are revised to redefine a director's fiduciary duty as being owed not just to shareholders but as well, and perhaps equally or even to a greater extent, to many other constituencies affected by the corporation.

There are various versions of the constituency amendment to states' corporate statutes defining the duty of directors. In all, approximately 25 states have installed the idea. The other constituencies typically mentioned include employees, suppliers and customers, communities in which the corporation operates and any other factors considered pertinent. Most laws are permissive. Some expressly seek to alter the orthodox notion that directors exclusively serve the interests of shareholders by elevating the many non-shareholder interests to equal status with shareholders and according directors wide discretion in weighing among them all. Others, such as one enacted this summer in New York, are ambiguous on the matter. Some are limited in effect to takeover situations, thus revealing more boldly their thwarting purpose; others apply generally to all actions by directors.

These changes are pernicious. They have the practical effect of making directors accountable to no one. They render incoherent the economic and legal underpinnings of the corporation's role in society. As former Chairman David S. Ruder said in a speech delivered May 22, 1989 in New York City, with reference to the Indiana version:

> The Indiana statute is misguided. By failing to consider the shareholder as paramount, the statute removes accountability for corporate management. . . .
>
> Concerns over the disruption caused by takeovers should be addressed directly, for example through plant closing laws such as that recently enacted by Congress, rather than by diluting management's accountability to its shareholders.

To attack these changes is not to say that non-shareholder constituencies deserve no attention in connection with changes of control. It is entirely appropriate for state legislators to seek, through substantive legislation, to ameliorate the harmful effects that a successful takeover may have upon their states' labor force or economy. However, giving directors wide discretion in the matter, and abandoning the economic orthodoxy of the corporate enterprise in the process, is simply not the right solution.

Although there was talk by the Delaware Supreme Court in Unocal of constituencies other than shareholders who could be considered by directors in responding to a hostile bid, the same court in Revlon confirmed that it had not meant to work any change in corporate accountability when it said:

> A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders." 506 A.2d 173, 182 (Del. 1986)

A multi-constituency statute, combined with a poison pill or one of the second generation anti-takeover statutes in effect will enable a board of directors to "just say no" to a demonstrably full priced all cash bid.

The SEC Constrained. Since the Supreme Court's decision in Sante Fe v. Greene, with the very important exception of Rule 19c-4, the SEC has been unable to construe the Exchange Act as embracing significant powers over corporate governance. And over the length of the Reagan Administration, the SEC has been unwilling to recommend that Congress establish minimum standards in the corporate governance area. This situation has left an imbalance of regulatory power at the Federal level, since the Williams Act accords the SEC more power to regulate the behavior of bidders than of their targets.

The Congress as Spectator. For its part, Capitol Hill has been a curious and at times active spectator to these developments, seemingly as unsure of whether there is anything sufficiently wrong to need repair as it is unsure of what repairs might make sense.

In sum, it is undoubtedly true, as Professor Jack Coffee of Columbia Law School says, that "the castle moat around management is deeper and the castle walls higher." Perhaps this is so because "excesses" in feverish takeover activity have begot excesses in the defense of management. But the fact remains: the moat is deeper and the walls higher. It is principally this fact, and the fundamental conflicts of interest on the part of management that the moat and castle leave unresolved, that led Professor Michael C. Jensen, in the current Harvard Business Review, to conclude:

> The publicly held corporation, the main engine of economic progress in the United States for a century, has outlived its usefulness in many sectors of the economy and is being eclipsed.

While the Jensen thesis may be somewhat overstated,the warning rests on solid evidence.

Stock Ownership

Now, here's what's happened to stock ownership since 1932 and, particularly, in recent years:

Growth in Institutional Holdings. The institutionalization of stock ownership has continued apace. Anise Wallace of The New York Times recently reported that corporate and governmental pension funds own almost half of all stock in the S&P 500 and 23.2% of all equities (this from 4% in 1960 and 9.4% in 1970). Pension funds are said to be the largest and fastest growing class of institutional investor. Total value of these funds exceeded $1.5 trillion in 1988.

Separation of Stock Ownership from Control. The separation of ownership and control in regard to the corporation, recognized by Berle & Means, is paralleled in regard to stock and other corporate claims. The bulk of investments are now divided into beneficial ownership (employees, families) and control (trustees or money managers with discretion, including advisers to investment companies). Further separation of beneficial ownership occurs by removing from the ultimate beneficiary any power to choose the medium of investment or the manager. The result of these trends is diffusion of ownership and multiplicity of interests among the various parties having something to do with the stock owned, who include, in the case of a pension fund, the corporation, its employees, the trustee, the managers, manager selection advisers, broker/dealers, union leaders, etc., etc. and affiliates and corporate parents of each of foregoing. This multiplicity of interests creates a vast potential for conflicts and vulnerability to firm pressures.

Indexing and other Passive Investment Techniques. New investment management techniques and products continue to be developed and are eroding the investor's sense of ownership in the firm. Indexing, for example, means that one does not hold an issuer because one particularly likes its management. That's beside the point. The portfolio becomes the security. Futures on stock and bond indices make it possible to buy or sell an entire equity or debt portfolio with speed and efficiency. These derivative products are becoming surrogates for the underlying securities. The Wall Street Rule -- love 'em or leave 'em -- becomes irrelevant. One is a buyer or seller for market driven reasons, often having nothing to do with management. Indexing now accounts for more than $200 billion in U.S. portfolios.

The most recent reflection of growing investor interest in the passive strategy of buying or selling "the market" was the New York Stock Exchange's June filing with the SEC, seeking permission to offer a basket trading product, known as "Exchange Stock Portfolios." Initially each ESP will be a standardized basket of stocks representing the S&P 500 index. Baskets filled with stocks representative of other indices could be offered in the future.

Primacy of the Asset Allocation Decision. With the growth in different forms of equity and debt and in the availability of reasonably coherent investment products in market centers around the world, many institutional investors are coming to view the matter of asset allocation among the different markets and within a single market among the different classes of investment as more important functions in the management of risk than the analysis required to pick particular corporations. The lessons of diversification and efficiency of markets lend some support to this allocation of the investment manager's time and effort.

Institutional Voicelessness. The continuing growth in institutional ownership has not, as one might have expected, led to closer oversight of management by shareholders. The Council of Institutional Investors, the United Shareholders Association, CREF, CALPERS and the other more active shareholders of public corporations are exceptions to a more general rule of passivity. If CREF and CALPERS hadn't existed, the corporate managements of our large publicly held corporations might wish to have "invented" them, because they give a vestige of reality to the notion that shareholders continue to have a voice over corporate affairs.

Most institutional funds do not spend money on the corporate governance of public corporations as these few institutions have done. Unless the institutions have a controlling position, the problems of collective action and the "free rider" makes such expenditures wasteful. And institutions as a rule are reluctant to take a control position or anything resembling it. Here it is interesting to contrast Japan, Germany, France and Sweden, where control over the corporation is exerted more by the powerful voices of dominant owners and creditors, particularly banks, than in the United States, where (among other differences) banks can't own equities.

The Rise of Non-Public Investments. Institutional investors are increasingly turning to non-public investments, whether through venture capital funds, real estate funds, takeovers, corporate breakups, divisional spinoffs, leveraged buyouts or otherwise. It is Michael Jensen's claim that the robust following these private investment vehicles enjoy derives principally from their ability to more completely align the interests of management with the interests of ownership. Management of public corporations, according to Jensen, has become insulated from effective monitoring. The high cost of being an active investor has left institutions "almost completely uninvolved in the major decisions and long-term strategies of the companies their clients own."

Efforts to Reshape the Conduct of Fiduciaries. Somewhat in parallel with the multi-constituency idea of corporate law, and with many of the same goals in mind, some voices have been heard to suggest a change in the fiduciary standards applicable to pension trustees, so as to enable them to serve broad economic goals as well as their beneficiaries and to be patient investors supportive of management. A recent Report of Governor Cuomo's Task Force on Pension Fund Investment is an example of this line of thought. To deal with the problem of voicelessness, that Report recommends imposing on trustees of public pension funds in New York duties to monitor, to communicate, to participate constructively in corporate governance and to be accountable, by (among other things) reporting on corporate control decisions.

Conclusion and Recommendation

The changes in managerial control and in stock ownership that I have sketched above threaten the old system of accountability to shareholders. Due to the deepening of the castle moat and the heightening of its walls, shareholders are becoming less and less able to hold management to account. And due to changes in investment management techniques and products, making exits easier, and the multiplicity of interests within the "ownership" group, creating diffusion and the potential for conflicts, shareholders are becoming less and less interested in holding management to account.

This problem is likely to be exacerbated as the globalizing tendencies of finance cast our system of corporate governance up against those of other centers of finance around the world. Performance of U.S. corporations in recent decades suggests the need for some modesty about our highly legalistic system. The other major systems of corporate governance mentioned earlier rely much more on control derived from the substantial ownership of a few institutional investors, particularly the banks, and a substantial creditor role: in short, there exists in these systems a close connection between the size of one's investment and the strength of one's voice.

If the thesis argued above is correct, serious attention to these fundamental changes, and their probable impacts on corporate accountability, is warranted. This matter deserves attention from the SEC and the Congress as well as from business leaders, investment professionals and the Bar.

It is my recommendation that Congress come to the rescue of such important, time honored and useful notions as the business judgment rule for corporate behavior, the prudent person rule for the management of other people's money and the public corporation as a trusted and reliable vehicle for attracting and holding the equity capital of non-controlling investors. At the state level, the wide variety of efforts to protect management from hostile takeover bids may be warranted if looked at in isolation, from a state perspective. However, these efforts are generating change and pressure for further change that entail mistreatment of these basic rules of corporate and investment behavior, to the ultimate detriment of the public corporation and the public interest.

What Congress should do in principle may be readily stated. It should add rules to the Williams Act that accord to shareholders of a public corporation the right to consider a bid for its shares, free of any act by management that frustrates that right unless the act has been consented to by a majority of shareholders. This system, in essence, is that presently administered so very well by The Panel on Takeovers and Mergers in England. As described by Lord Alexander of Weedon, head of the Panel since 1987, in a recent article for The Economist, the central features of the Panel Code are fourfold:

> First, the requirement of equal treatment for all shareholders of a certain class--hence the mandatory bid once a stake reaches 30%. Second, that all shareholders must have equal information and a reasonable time to consider it, so that the bid can be resolved against an orderly time-scale. Third, that the management of the defending company should take no frustrating action without the consent of its shareholders. Fourth, the requirement of disclosure, to assist in achieving that most elusive of concepts, the fair market. . . .
>
> The third of these principles--no frustrating action--is of central importance to the orderly conduct of takeovers. It reflects the fact that, as is clearly demonstrated in the United States, management under pressure does not always find it easy to distinguish between its own interests and those of its shareholders. This provision of the code has no counterpart in America. The role of the Securities and Exchange Commission (SEC) there is limited, being concerned essentially with disclosure

> and not with ensuring that the bid can actually be decided by shareholders in a proper time-scale.

It is my view that a federal solution, built generally upon the principles of the Panel Code, is not only desirable, but necessary to avert further damage to the systems by which our public corporations are managed and our institutional wealth deployed.

Bevis Longstreth
October 2, 1989

Senator DODD. We'll have some comments on that suggestion, I'm sure, along the way.

Mr. Monks.

STATEMENT OF ROBERT A.G. MONKS, PRESIDENT, INSTITUTIONAL SHAREHOLDER SERVICES, WASHINGTON, DC

Mr. MONKS. Mr. Chairman, thank you very much for inviting me. You have my testimony. You have more of my testimony probably than you want. You have a summary of my testimony.

Senator DODD. That I enjoyed, yes. [Laughter.]

Mr. MONKS. In view of the fact that I lack the ingenuity of my predecessors for claiming time at the microphone——

Senator DODD. Do you have a solution to this problem? [Laughter.]

Mr. MONKS. I'd like to give you a change of pace and give you the solution immediately.

What is the problem?

The problem is we thought that, in America, we don't have long-term shareholders.

Mr. Chairman, this is a misconception. We do have long-term shareholders. The long-term shareholders are our pension funds. The pension funds are locked into the paradigmatic chase that Andy Sigler outlined for you, where everybody for seemingly good and sufficient reasons has to do something that injures everybody else.

Mr. Chairman, I think there's an answer to this. For the moment, I just want to address myself to the private pension system, which is already regulated by ERISA.

There are those who can speak more knowledgeably and with more credibility about the public system. But, obviously, for jurisdictional reasons, it's easier to deal with something where the Federal government already has the authority. There's no preemption problem and the preponderance of the money is in the private system.

Mr. Chairman, I would like to remind you that the Congress in its wisdom has already dealt with this question of long-term shareholders.

When the Congress had to revise a pension system for the most important Americans, by which I mean federal officials, including yourself, the Federal Government in the Federal Employment Retirement System Act of 1986, provided for investment in equity securities—as part of your pension plan, Mr. Chairman.

It provided, however, that if you were going to invest in equities, the only mode by which you could do that was through an index. And the Congress considered this subject at great length.

Among its other conclusions was the conclusion that investing the equity portion of your pension savings in an index did not cost you money.

Mr. Chairman, it's been said that figures lie and liars figure, and in no walk of life is this more apparent than in the evaluation of performance by investment advisors.

It is, however, as certain as certain can be that during the period since the passage of ERISA in 1974, that the active management of

ERISA funds has not added value in comparison with the indexed management of ERISA funds.

Therefore, you are not acting adversely to the protection of pensioners' interests when you say—to the extent that they have an equity investment, the equity investment must be in the medium of an index.

My proposal is not that this be required, but that this be established as a safe harbor.

Mr. Chairman, because in the private system, the liability for paying a pension remains with a company. The company should always be able to take a risk if it wants to, and there are—a relatively few, to be said, but there are, like Mr. Kirby, a very few genius managers in this country who always beat the index. And the opportunity to avail one's self of such competency should not be denied to corporations.

But, in general, if one made the holding of equities in an index as a safe harbor, it would have the tendency to encourage people to put their funds there.

Thus, you have a system where 20-30 percent of the total equity in the American system is held by, as Mr. Longstreth said, the quintessential long-term holder, the index fund.

We then need to borrow one change from the English. That is that, in the case of tenders in England, you are permitted to vote against the tender. In the event that the tender goes ahead, you then have the opportunity to put your stock at the tendering price to the tendering company. Because an indexed fund is obligated to match whatever index is contractually offered to customers, it doesn't under existing American law, have the option of refusing to go along with a tender. So, in order to keep the balance, we will have to adopt the English system.

But, think, if you will, Mr. Chairman, of a system in which we, like the Germans, like the Japanese, and sort of like the English, have a 20-30 percent "permanent" shareholder base that consists of trustees, who are subject without question to federal regulation. They are currently being regulated by the U.S. Department of Labor.

And 20-30 percent is a stable base on which we can base long-term planning of the kind that Mr. Sigler needs. There are rules in place about what should be done by owners as a matter of prudence. By allowing or by providing for investing the funds in an equity index, you liberate money managers, plan sponsors and beneficiaries from the vicious circle of which Andy complains.

This is a way of making a systemic change which permits and encourages long-term holding and an increase of competitiveness of American industry.

Thank you, Mr. Chairman.

[The complete prepared statement of Robert A.G. Monks follows:]

UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING

AND URBAN AFFAIRS

The Role of Institutional Investors in Corporate Governance and Capital Markets

Testimony by
Robert A. G. Monks
President, Institutional Shareholder Services

SUMMARY

Takeovers are not the disease; they are only the symptom. The economists who refer to them as "market corrections" are right. But they are violent corrections, made possible--and profitable--by market failures.

The collapse of the system of corporate governance has left management unaccountable to shareholders. That gives corporate management and raiders both the incentives and the opportunity for exploitation and abuse of shareholders. And that has led to this redirection of corporate energy and imagination toward takeovers and defenses against takeovers and away from productivity.

This is only possible because an integral part of the contract between those who provide the capital (shareholders) and those who provide the labor (corporate management) has all but disappeared, due to rampant inefficiency and abuse in the most important mechanism for shareholder communication--the exercise of ownership power and responsibility, primarily through voting of proxies and evaluating tender offers. If it was restored, the market would permit only those mergers and acquisitions that benefit all parties.

The incentive for takeovers comes from a gap between two markets. The first market is the market price of the stock. The second market is the price of control. The profit comes from arbitraging the gap. The gap exists only because the market sees control as without value when it is held by widely dispersed shareholders, and highly valuable when it is held by one or more owner/managers.

There is a real temptation to use pension fund assets to meet other social goals. The recent report issued by the New York State Task Force On Pension Fund Investment is the most recent example. What troubles me most about the idea of using pension fund assets (private or public) for goals unrelated to the traditional standards of risk and return is that these recommendations are generally made without regard to the costs, which will be borne elsewhere, most likely by the taxpayers. These policies are expenditures of public funds, and should be subject to the same procedural requirements as any other budgetary outlay.

It is possible, though, to strengthen pension funds' commitment to plan participants with a policy that also establishes them as constructive contributors to America's corporations. I suggest that we make indexing a "safe harbor," a per se prudent investment to meet ERISA standards. Establishing indexing as a permissible, even welcome, ERISA investment strategy will encourage the creation of a firm, consistent financial infrastructure.

In addition to its quieting effect on trading volume and its reliable returns, it provides an important incentive for constructive shareholder involvement. A fiduciary whose trading choices are self-activating must avail itself of every other mechanism, whether through the proxy system or a shareholders' derivative suit, to protect and enhance the assets that it manages for others.

Involvement does add value. Our recent experience at Honeywell, with the first-ever defeat of management proposals by a group of shareholders, led to a surge in the share price, kept in place by a restructuring.

The impediment to more supportive involvement by shareholders is that artificial constraints inhibit, even prevent, the functioning of the market.

1. Collective choice Shareholders are presented with two choices, one which benefits each of them individually, and one which benefits the group. The choice is framed in such a way that acting alone, shareholders will chose the first, even though the second will provide higher benefits for all.

2. Logistics The playing field is far from level, with shareholders underwriting both sides of any disagreement with management. There are restrictions limiting shareholders' ability to identify and contact each other, and limiting their access to the proxy materials circulated by management.

3. Conflicts of interest Because corporate management knows how the fund managers vote, and the beneficial owners do not, fund managers have been known to bend to pressure from their other clients and customers, commercial interests outweighing fiduciary obligations.

4. The Race to the Bottom While the reasons for governmental action are increasing, the traditional arguments for leaving regulation of corporations to the states have, after 200 years, begun to erode.

The agenda for shareholder involvement should be limited. By devoting their attention to the structure that determines the relationship between shareholders and directors, they can make sure that the interests of shareholders and directors (and management) are aligned. Once that is ensured, shareholders can be confident that the day-to-day operations of the company will be in their long term best interest.

Institutional shareholders can provide American companies with a solid infrastructure of capital. Pension funds can maximize long-term returns with investment strategies that benefit the corporations as well as the shareholders. Hostile takeovers and proxy contests are a last resort; given the opportunity to reduce agency costs through constructive involvement in corporate governance, the shareholders will do so. It is not just the best possible investment in the company; it is the best possible investment in the American economy as well.

INSTITUTIONAL SHAREHOLDER SERVICES, INC.

UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING
AND URBAN AFFAIRS

The Role of Institutional Investors in Corporate Governance and Capital Markets

Testimony by
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It may therefore be observed, in conclusion, that there is something to be said for the system, which seems to be evolving under the pressure of taxation, in which the shares of large companies are held, in large blocks, by institutions - banks, pension funds and so on - which have a sufficient stake in the company to have an incentive to keep in close touch with its affairs, just as the holder of a non-transferable share has an incentive to do. Such a system could indeed be regarded as that of the private company writ large. It would indeed lose something, perhaps much, in flexibility; but it could offer gains in other ways.
Sir John Hicks, Limited Liability; the Pros and Cons[1]

Large pools of capital such as pension funds and endowments don't really need the liquidity the public market offers. Liquidity serves two basic purposes. It allows investors to meet unexpected cash needs and to trade their stocks. Unlike individuals, the large funds can project their cash needs well into the future based on predictable factors such as employee demographics, life expectancies, and health trends. So they can take a long-term view of investment returns and keep their holdings in illiquid assets.

Fund managers are also realizing that trading is a tough discipline in which they hold little comparative advantage. Trading is a zero-sum game played in a fairly efficient market against equally talented rivals. Worse still, large funds face diseconomies of scale when executing trades. The larger a fund, the more difficult it is to trade quickly, based on transient information advantages. The very act of trading moves markets. Still, these managers remain charged with generating returns in excess of passive benchmarks. Enter the market for private assets such as real estate, venture capital, and, more recently, the market for corporate control and restructurings. Instead of trading a large number of small, liquid positions, the funds can buy and own smaller numbers of large, illiquid positions in a form where they (or more likely their agents) participate more actively with management in the control of the assets. This alternative can be a positive-sum game; real changes in corporate policies can be a route to enhanced value. The very large funds also have a competitive advantage here. The larger their positions, the more actively they can participate in the ownership and management of the underlying assets. In the extreme, as with LBO funds, these changes can

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[1] Limited Liability and the Corporation, p.20, Tony Orhnial, ed.

> be dramatic. The LBO fund itself becomes the managing owner in partnership with company managers. In short, large institutional funds can behave more like owners and less like traders.
> *Jay O. Light*, The Privatization of Equity[2]

I believe that the issues we will be discussing today are as critical to the health of the United States' economy as any ever addressed by this Committee, and I am pleased to have the opportunity to share my views.

Hostile takeovers and leveraged buy-outs, almost unheard of 15 years ago, have now affected every aspect of the market. There is hardly a Fortune 500 company that has not been either a target or an acquirer--or both. I do not believe there is any publicly traded company that has not taken some steps to protect itself from a possible takeover, from adoption of a poison pill or staggered board to support for state-anti-takeover legislation--or, if the state will not cooperate, reincorporation in a state that will.

Takeovers are not the disease; they are only the symptom. The economists who refer to them as "market corrections" are right. But they are violent corrections, made possible--and profitable--by market failures. The collapse of the system of corporate governance has left management unaccountable to shareholders. That gives corporate management and raiders both the incentives and the opportunity for exploitation and abuse of shareholders. And that has led to this redirection of corporate energy and imagination toward takeovers and defenses against takeovers and away from productivity. This is only possible because an integral part of the contract between those who provide the capital (shareholders) and those who provide the labor (corporate management) has all but disappeared, due to rampant inefficiency and abuse in the most important mechanism for shareholder communication--the exercise of ownership power and responsibility, primarily through voting of proxies and evaluating tender offers. If it was restored, the market would permit only those mergers and acquisitions that benefit all parties.

The incentive for takeovers comes from a gap between two markets. The first market is the market price of the stock. The second market is the price of control. The profit comes from arbitraging the gap. The gap exists only because the market sees control as without value when it is held by widely dispersed shareholders, and highly valuable when it is held by one or more owner/managers.[3]

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[2] *Harvard Business Review*, September-October 1989, p. 63.

[3] See Howard D. Sherman, *Buyers of Control Get a Lot More Than They Pay For*", Wall Street Journal, 1/24/89.

Some takeovers are good, and some are not. Some result in a more efficient allocation of resources, and make a company more competitive. Others can be just paper deals, turning equity into debt, and making no real improvement in operations. The problem is that the current system does not permit shareholders, who are best able to distinguish between the two, to do so. The result is too many hostile, debt-laden takeovers that have less to do with economic fundamentals but are instead driven by the availability of enormous advisory fees, arbitrage opportunities, and size for its own sake. The excesses are causing negative side effects that will come back to haunt the economy in future years; some are already apparent today: a slowdown in research and development, too much of management's time devoted to short-term gains and takeover defenses at the expense of long-term planning, and an overleveraged economy.

We need takeovers, not only as market corrections of last resort, but as a constant reminder to management that they must remain accountable to shareholders. That accountability is necessary not only for economic reasons, but also for public policy reasons. If those who contribute capital are not able to rely on the total commitment of those who oversee the day-to-day operations, then there is no justification for delegating to private entities the authority to determine so many aspects of American life. The system will suffer a severe lack of confidence, requiring government intervention.[4]

Before we discuss improvements to our system, it is useful to look at other examples. The United States, like its OECD partners, has a "free" economy characterized by private ownership of its principal industries whose shares are publicly traded. While other countries exhibit the same control premium over the trading price, they have avoided our violent solutions. In Japan, Germany and Great Britain, like the United States, ownership is divided between long term and short term holders. In each country a large enough portion of the equity to assure control is held by groups who are not interested in short valuation swings on the market, Japan through inter-corporate holdings within industrial groups, Germany through "universal bank" holdings, and

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[4] "So long as the management has the one overriding duty of administering the resources under its control as trustees for the shareholders and for their benefit, its hands are tied; and it will have no arbitrary power to benefit this or that particular interest. But once the management of a big enterprise is regarded as not only entitled but even obliged to consider in its decisions whatever is regarded as the public or social interest or to support good causes and generally to act for the public benefit, it gains indeed an uncontrollable power -- a power which could not long be left in the hands of private managers but would inevitably be made the subject of increasing public control." F.A. Hayek, The Political Order of a Free People, (University of Chicago, 1979), p. 82.

Great Britain with relatively disciplined and mutually cooperative institutional investors, who are accepted as representative of the public interest. The Japanese government deals very directly with the industrial groups, the German government has direct access through the universal banks; and the Bank of England sponsored the establishment of the various organizations, like the National Association of Pension Funds, which channel collective action by owners. Thus, whatever gyrations occur in stock market value, there is no correlative impact on the control of corporations and national resources are not skewed towards the achievement of short-term profits. The stable, long-term ownership groups in these countries have objectives that are consistent with national priorities, both economic and policy.

In the United States, on the other hand, the inevitable "value gap" between trading and control prices of corporate shares has created increasing pressure for unproductive takeovers. While, like Japan, Great Britain, and Germany, we have a large portion of our capital in the hands of institutional investors (anticipated to hold half of all equities in this country within the next 10 years), our institutions have not provided the same stable base. They have operated under the traditional "Wall Street Rule"--vote with management or sell the shares.[5] And we have allowed both corporate managers and raiders to present them with bad choices, where they are forced to accept a small premium instead of staying with the company for higher returns over the long term.

This is unnecessary. and it can be stopped. The pension fund system, now in control of more than $2 trillion, is a suitable American counterpart to the Japanese and European "permanent investor," and an ideal source of "patient capital" for American industry.[6]

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[5] Under the option of "voting with one's feet," often known as the traditional "Wall Street Rule," shareholders should either vote with management or sell their shares. The theory here is that if enough shareholders become unhappy and sell out, management will have to change its policies to attract new shareholders. Yet, as Edward Jay Epstein points out, "just the exchange of one powerless shareholder for another in a corporation, while it may lessen the market price of shares, will not dislodge management -- or even threaten it. On the contrary, if dissident shareholders leave, it may even bring about the further entrenchment of management -- especially if management can pass new by-laws in the interim."

[6] It must be recognized that other institutional holders - quintessentially the mutual funds - have no such structural bias towards becoming permanent holders. Individuals buy shares in mutual funds, because they believe that the managers can achieve the advertised results through the inspired investing and trading of securities. There is no representation

Your objective for governmental action at this time should be to eliminate the constraints that presently inhibit private pension funds[7] from exercising the broad oversight that was the original justification for the system of private corporations. By doing so, you will permit limited, but constructive involvement by shareholders that will put the control premium where it belongs--in the trading value of the shares.

The initial task is to establish that the private pension systems function as long-term investors in equity securities.[8] In order to do so, we must remember the reasons for agglomerating such a substantial portion of the country's assets in the hands of fiduciaries. The principal objective continues to be to assure the fidelity and financial competency of the employer to honor the "pension promise." The passage of ERISA was fueled by concern for workers and retirees, and the statute provides as plainly as language permits that its "sole" mandate is to manage the plan assets for "exclusive benefit" of plan participants. The statute was based on the strictest model ever developed by our legal system, traditional common law of trusts. ERISA then went

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or implication that mutual funds will function otherwise than in this way. To consider them as owners in the same sense as pension funds is to ignore reality.

This is not to suggest that mutual funds do not have and should not be required to exercise responsibilities of ownership. It is merely to point out that their organizational momentum inclines them in the direction of trading; that they have little institutional pressure to consider the "long term" profitability of portfolio investments; and that, therefore, they do not have the same intrinsic qualities as the pension funds to take on the primary responsibility of long term ownership. They could be expected, however, to use their ownership right in a value enhancing way.

[7] Although our argument applies with equal weight to both public and private pension systems, our focus here will be on the private pension system, with 20% ownership of total U.S. equity, because preemptive federal jurisdiction has already been established pursuant to ERISA. Many of our recommendations are directed at shareholders in general, and thus would benefit public pension funds, mutual funds charitable endowments, and individual investors.

[8] We respectfully disagree with Senator Kassenbaum's proposal to tax short-term gains (S. 1654), but note that it is intended to achieve just this goal. In her statement on the bill, she said, "It does not seek to raise revenue, and in fact, I would be completely happy if it did not raise a penny."

even further to ensure the scrupulous and complete devotion of all efforts to protection of pension assets.[9]

But traditional trust law never contemplated a group of beneficiaries as large and diverse as ERISA beneficiaries. What is the "exclusive benefit" of a group that includes new employees, employees approaching retirement, and retirees? And traditional trust law never permitted a fiduciary with a built-in conflict of interests, as a plan sponsor is presented with under ERISA. There will be times when the interests of the company and the interests of the pension plan participants collide. ERISA makes it clear that the duty is to the pension plan in that case, but in practice that standard has been difficult to understand and enforce.

And the difficulty is increasing. During the fifteen years since the passage of ERISA there has been such progress in funding "accrued pension liabilities" that inevitably attention has turned to other possible uses of the pension assets. As Doonesbury's Uncle Duke said, "But the pension fund was just sitting there!" Governor Mario Cuomo convened a very distinguished panel of experts for the New York State Task Force On Pension Fund Investment, which wrote a report on the role that New York's public pension funds should play in the capital markets. The Report, entitled "Our Money's Worth," called for a wider range of investments, based on a wider range of investment objectives, based on a broader interpretation of the notion of beneficiaries. Speaking at a press conference unveiling the Report, Governor Cuomo said, "You need wealth. In this state, we have great debt, a great demand. We need wealth and there it is : nationwide, $2 trillion worth of it. Nobody knows what it does. Nobody knows how it works. The Media doesn't; the politicians don't... We have hundreds of billions of dollars and can't find the money to build jails. We have hundreds of billions of dollars and we can't find money to build roads and bridges. Hundreds of billions of dollars -- yours...So now they're asking for pension supplementation and they're sitting on billions of dollars in pension funds. I mean, you can't make a deal? You can't sit down and say this is interesting: you're interested in pension supplementation, we're interested in using the pension fund."

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[9] The Supreme Court has said, "(R)ather than explicitly enumerating all of the powers and duties of (ERISA) trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility...The manner in which trustee powers may be exercised, however, is further defined in the statute through the provision of strict standards of trustee conduct, also derived from the common law of trusts--most prominently, a standard of loyalty and a standard of care. Under the former, a plan fiduciary "shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and...for the exclusive purpose of providing benefits to participants and their beneficiaries; and...defraying reasonable expenses of administering the plan." 29 U.S.C. Sec. 1104(a)(1)(A). See also Sec. 1103(c)(1); cf. Sec. 186(c)(5). Under the latter, a fiduciary "shall discharge his duties with respect to a plan...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." Sec. 1104(a)(1)(B)." *Central States, Southeast and Southwest Areas Pension Fund v. Central Transport*, 472 U.S. 559 (1985).

Governor Cuomo's comments reflect the real temptation that public pension funds present.[10] It is quite similar to the temptation presented by private pension funds, sometimes with assets and liabilities larger than those of the sponsoring corporation. These funds have been so enticing that they have been plundered by plan sponsors and raiders, leaving plan participants little better off than they were before ERISA was passed.

Diverting pension assets to other - doubtless worthy - goals beyond the "exclusive benefit of plan participants" imposes costs. The question is what the costs are and who will pay them. What troubles me most about the idea of using pension fund assets (private or public) for goals unrelated to the traditional standards of risk and return is that these recommendations are generally made without regard to the costs, which will be borne elsewhere, most likely by the taxpayers. These policies are expenditures of public funds, and should be subject to the same procedural requirements as any other budgetary outlay.

It is possible, though, to strengthen pension funds' commitment to plan participants with a policy that also establishes them as constructive contributors to America's corporations. After all, anything that makes these companies more productive and competitive is a legitimate investment objective for a fiduciary managing funds for the

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[10] Public pension funds are also especially vulnerable to diversion for social policy goals, like divestment from companies doing business in South Africa. These programs are sometimes ineffective as well as costly. The New Jersey state plan was directed by state statute to divest completely from any company doing business in South Africa. It did so, at a cost of 330-515 million dollars over two years. It also ended up selling out of two New Jersey pharmaceutical companies whose only dealing with South Africa was the sale of medicine used exclusively by Blacks. This policy fails on fiscal, political, and moral grounds, by any standard. This is no different from taking as much as 515 million dollars out of the state budget and spending it on a program--on one, which at least in this case, cannot be said to be a successful one. Our detailed analysis of the Task Force Report is attached.

"exclusive benefit" of pension plan participants. Pension plans can provide the infrastructure for corporate finance in a manner that maximizes long-term returns for the beneficial holders, and one of our top public policy priorities should be to remove impediments to their doing so.

One thing we have learned from the first 15 years of ERISA is that active management of corporate pension funds' equity portfolios has on net resulted in lower returns than investment in portfolios that replicate the market (passively managed, or index funds).[11] I include here as part of my testimony today the testimony I presented earlier this year to the Subcommittee on Labor-Management of the House Education and Labor Committee. (copy attached) In that testimony, I suggest that we make indexing a "safe harbor," a per se prudent investment to meet ERISA standards. This is not a requirement, by any means. And many people will--and should--continue to try to beat the market with a number of different strategies. But establishing indexing as a permissible, even welcome, ERISA investment strategy will encourage the creation of a firm, consistent financial infrastructure. It is noteworthy that the Congress itself has taken such a legislative step, with regard to its own pension fund, and that of other federal employees, in the passage of the Federal Employees Retirement System Act of 1986. It mandates that equity investments must be made through the mode of index. Promulgation of such a regulation by the Department of Labor would very substantially affect the present method of investing of pension funds and would make short term considerations irrelevant.[12]

Indexing has other benefits. In addition to its quieting effect on trading volume and its reliable returns, it provides an important incentive for constructive shareholder involvement.[13] A fiduciary whose trading choices are self-activating must avail itself of every other mechanism, whether through the proxy system or a shareholder's derivative suit, to protect the assets that it manages for others. To the extent a fiduciary makes equity investments through the route of indexing, the only way to add value through management is through being informed about and involved with the functioning of portfolio companies. Index fund managers have an obligation to monitor and analyze ownership issues that is even greater than that for managers of other funds, because indexed funds provide no discretion for asset managers with regard to trading.[14] Index fund managers do not have the option of selling the stock if they do not agree with management's proposals; they have to wait until it sinks far enough to fall off of the index. Certainly, a fiduciary cannot stand by and allow a firm in which it holds shares to siphon off corporate assets with no return in value to beneficiaries, just because the mechanism used is the vote rather than money. A fiduciary whose trading choices are self-activating must avail itself of every other mechanism, whether through the proxy system or a shareholders' derivative suit, to protect and enhance the assets that it manages for others.[15]

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[11] See attached "Boxscore" from Wilshire Associates.

[12] Andrew C. Sigler, Chairman and CEO of Champion International Corporation, said recently "The private funds--with maybe a couple of exceptions such as General Motors and General Electric companies who run their own funds--don't think of themselves as owners. They think of themselves as investors. I've sat through meetings of our own pension committee and a couple of others for boards I'm on and never does a name come up of whose companies they own. Never does the thought hit the group that they own anything. It's all what percentile, what quartile, how did they do last month. So here we sit. I'm at least 70% owned by these people...The share price today is refined constantly by that proverbial young man looking at a CRT screen."

[13] "The funds are now so large that indexing is inevitable--in effect, if not by intent. In light of that reality, what I advocate is that a pension fund, first, intelligently select the indices in which a large portion of its assets are to be invested, bearing in mind the promotion of real economic growth over the long term, and second, follow proxy voting

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policies that encourage the corporations that are in its portfolio to pursue the same goal." Ira M. Millstein, *Why Boards of Directors Must be Actively Involved in Corporate Pension Fund Investment Policy*, Insights, September 1989, p, 25.

[14] Once a safe harbor is created, the question naturally arises as to by whom and how the responsibilities of ownership should be exercised. Right now, index fund managers may vote according to their evaluation of the issues, but they do not have that option in responding to tender offers; they must tender, if a majority of the other shareholders do. Index funds will be able to exercise a supervisory function with respect to tenders only if we adopt a rule that permits voting against tenders and yet preserves the right to put shares if the tender is successful, as they have in Britain.

Again, the issue is the "prisoner's dilemma." While it is plainly in the competitive interest of the index fund system to devote resources to enhancing values of the weaker components, it is hard to argue that any one index manager can justify such a commitment - his essential commitment is to "track" the index, not to improve it. An "index fund system" will require a collective competency to research and make recommendations as to voting and tendering portfolio securities. ERISA plainly permits the delegation of "ownership responsibilities" to an "investment manager," but no recommendation is yet appropriate as to whether the collective action should be limited to research and agenda setting or whether it should extend to voting and tendering.

[15] Nowhere has this been better said than in the June 15, 1987 edition of Barron's by Tom Flanigan, Chief Investment Officer of the California State Teachers' Retirement System:

Involvement does add value. During the late spring of 1989, we worked with a group of investors to prevent the management of Honeywell, Inc from enacting charter amendments that would have decreased management's need to be accountable to its owners. The proposals were clearly contrary to the shareholders' interests--they were to stagger the terms of the members of the Board of Directors and to eliminate the shareholders' right to act by written consent. The shareholders' successful opposition was unprecedented for several reasons, most important being that it was the first time there has ever been a full-scale proxy contest over issues unrelated to control of the company. The shareholders decided that their real objectives could best be served not by takeover or by "putting Honeywell into play," but rather by protecting their rights as owners and behaving as informed and involved participants.

The results were impressive. The evidence that shareholders were concerned and active at Honeywell, a company with universally acknowledged disappointing performance over the past few years, was a significant factor in the company's restructuring early this summer. The result of all of this was an increase in the value of Honeywell stock substantially in excess of general market action, as shown in the attached report.

Many of these public pension funds are beginning to realize that they have common problems and objectives. As fiduciaries we are responsible for adding value to our funds. One of the results of indexation is the fact that we are "blessed" with enormous proxy power, both social and financial. Up until recently there has been a lack of a coordinated effort to leverage this option among public pension systems. In my judgment, the day of picking managers that pick stocks that have difficulty outperforming indexes is drawing to a close in the domestic arena.

I believe that in order for us to add value, we must target underperforming companies and work with them more closely in order to develop a greater understanding of their goals and objectives, operating plans and earnings expectations, and monitor of those expectations thereof. This could potentially involve placing members on Boards of Directors. If in fact objectives are not satisfied, Management and Boards could possibly be replaced. It is obvious that the common problems and fiduciary responsibility of public pension funds will dictate a more coordinated approach as regards the use of financial proxy power.

The bottom line is these are our companies and it is my belief that we will take greater care in the future that they are managed efficiently and productively.

There is, therefore, significant evidence that shareholder involvement is perceived by the market as value-enhancing. We should be able, therefore, to count on market forces to elicit appropriate ownership action. But troublesome restrictions, generally the result of other policy goals and enacted without contemplating meaningful shareholder involvement, make it unnecessarily difficult to respond to the opportunities to enhance value through shareholder involvement.

Artificial constraints inhibit, even prevent, the functioning of a market in ownership involvement in corporate affairs. Economist Michael Jensen has written often and persuasively about the value added to corporations by the reuniting of ownership and control.[16] In testifying before the House Ways and Means Committee on February 1 of this year, he described the legal constraints erected over the last half century on institutions acting as active shareholders (including service as a director): "The result of these political and other forces over the past 50 years has been to leave managers increasingly unmonitored...The banning of financial institutions from fulfilling their critically important monitoring role has resulted in major inefficiencies." Journal of Applied Corporate Finance, Spring 1989, at p. 36. By removing these obstacles, government can permit market forces to develop the ultimate mechanism for effective shareholder action.

1. The Problem of Collective Choice

The first obstacle is the problem of "collective choice," also known as the "free rider" problem or "the prisoner's dilemma." All three terms are used to describe the situation where individuals are presented with two choices, one which benefits the individual, and one which benefits the group. The choice is framed in such a way that acting alone, individuals will chose the first, even though the second will provide higher benefits for all. The classic example is one-share, one-vote. Acting individually, even the largest shareholder will sell his vote for almost any price, despite the fact that the result will diminish the value of the shares held by all of them. Similarly, two-tier tender offers coerce shareholders to move quickly to accept the more attractive price offered to the first 50 percent only, although even the more attractive price may be less than they would have accepted without coercion.

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[16] Most recently, he said in the current issue of the Harvard Business Review that for at least some industries, public ownership has outlived its usefulness. *Eclipse of the Public Corporation*, September-October, p. 61. See also attached paper, *LBOs and the Reemergence of Institutional Monitoring of Managers*, 8/30/88.

The evidence shows that collective action will always benefit shareholders. But collective choice problems exist because any individual will have to pay all of the costs of action for only a pro rata share of the returns, if there are any. This is particularly serious for trustees, who must justify their actions as fiduciaries. The trustee must be able to justify how his stewardship has enhanced the value of their trust account. Even in cases, which are not uncommon, where a public pension fund owns 1, 2 or even 7% of a company, it is difficult to feel confident that every dollar of expenditure even in the clearest cases of owner abuse (i.e. legal fees in contesting "greenmail" payments) produces a dollar of increased worth for the beneficiaries. As a practical matter, some arrangement will be necessary for the equitable spreading of the costs of activism pro rata among the owners. The shareholder derivative action or class action provides an instructive model, where representatives can be certified and thus obtain reimbursement. I am attaching to this testimony a shareholder resolution calling for the creation of a shareholder committee, which would serve a similar function.

2. The problem of logistics

The collective action problem is especially problematic for shareholders, who face a range of other impediments to collective action. Once collective action becomes economically feasible, a whole range of potential legal problems needs to be dealt with. Policies favoring privacy and liquidity have led to the system of stock registration in nominee name, creating a labyrinth that makes it all but impossible for shareholders to identify each other, much less contact each other. Management has a shareholder list, but the shareholders do not. Even if they get one, the registration rules make it impossible to identify the individuals who exercise the ownership rights.

And the playing field is far from level, with shareholders underwriting both sides of any disagreement with management. A shareholder resolution may be included in the company's materials, but management has the opportunity to respond to shareholder proposals, while the shareholders do not have the opportunity to respond to management proposals.

Election of directors is even more troublesome. Edward J. Epstein points out that shareholder elections "are procedurally more akin to the elections held by the Communist party of North Korea than those held in Western democracies." Except in the rarest of cases, there is only one slate of directors running for office, and management controls the voting process and counts the votes. Management has the opportunity to use the company materials to nominate directors; shareholders do not. When shareholders do oppose management, they underwrite for both sides. They pay for the company's materials, through the corporate treasury, as well as any materials they develop and circulate in opposition.

Professor Alfred F. Conard has discussed impediments to collective action in several articles, notably "Beyond Managerialism: Investor Capitalism."[17] They range from the question as to whether institutions acting collectively constitute "controlling persons" under the 1933 and 1934 Securities Acts for various regulatory and reporting purposes to whether they will be deemed to be "insiders" for the purposes of the short swing profit (16-b) provisions of the Exchange Act.

3. The Problem of Conflicts of Interest

As documented in Conflicts of Interest in the Proxy Voting System, published by the Investor Responsibility Research Center, and the 1986 Report of The Subcommittee on Oversight of Government Management of the Senate Committee on Government Affairs, The Department of Labor's Enforcement of ERISA, institutional investors are subjected to the most extreme conflict of interest pressures. Institutional fund managers do not get paid extra for voting; indeed, hardly anyone knows if they vote or not. Fund managers bend to pressure from their other clients and customers, commercial interests outweighing fiduciary obligations.

The key obstruction to normal market efficiency here is that the client/consumers, beneficial owners of the stock (like pension plan participants) do not know how the stock is being voted, so they have no way to direct those who act on their behalf, or to evaluate their performance. The companies, on the other hand, do know who votes their stock and how it is voted, and they can, and do, apply pressure, threatening to take their business away from managers who do not vote with them. This has led to intolerable conflicts, with the lending side of banks overruling the trust side on voting decisions.

Voting has quantifiable economic consequences, and that means that a pension manager whose statutory obligation is to act for the "exclusive benefit" of plan participants must evaluate the voting choices with as much "care, skill, prudence, and diligence" as he does his trading choices.[18] Under the current system there is no way to hold the manager accountable for that duty of care. One possible solution would be to make votes confidential. If the corporations don't know how the institutions vote, they cannot threaten them for failing to vote with management. Another proposal would be to notify beneficiaries of the votes made on their behalf. The California state legislature has enacted such legislation, but only for those funds not governed by federal law. (See attached)

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[17] 22 U Mich LRev. 117, 157-163 (1988). (Attached)

[18] See Letters from Deputy Assistant Secretary of Labor Alan D. Lebowitz, February 23, 1988 (Avon letter) and February 23, 1989 (Polaroid letter).

My own recommendation is for confidential voting before the meeting, disclosure by fiduciaries afterward. That provides both protection from improper pressure, and information to beneficiaries and consumers. Federal legislation could also make specific the right of beneficiaries to bring a cause of action for breach of fiduciary duty to vote proxies to maximize return.

4. The Problem of the Race to the Bottom

While the reasons for governmental action are increasing, the traditional arguments for leaving regulation of corporations to the states have, after 200 years, begun to erode. It is increasingly evident that the current abuses are made possible by the failure of the states to enact effective laws. That is because the traditional justification of worthwhile experimentation being incubated by competition among the states is, or has become, seriously flawed. Competition only works if the states must bear the costs of the benefits they provide to entice corporations. Imagine, for example, that a state had the authority to exempt corporations from all federal environmental laws. Every state would enact this legislation to encourage corporations to incorporate there, but I would bet that they would insist that the factories be located elsewhere. Economists call this an externality, and that is the problem with state corporation law. Delaware can make its laws as liberal as it wants because it bears such a tiny proportion of the consequences, and that proportion is vastly outweighed by the benefits of the tax revenue. The "race to the bottom" continues as the Delaware court upholds poison pills in the Household case, permits Time to take away the shareholders' right to determine the fundamental structure of the company, and allows Polaroid to establish an ESOP to defend itself from a takeover attempt. The Delaware legislature continues the race to the bottom by exempting corporate directors from the liability for negligence applicable to all other categories of workers and enacting antitakeover provisions that impose on shareholders limitations that they could have adopted for themselves if there was any value in them.

State after state responds to the prospect of takeover of a local company--or the opportunity to get some of Delaware's corporate tax revenues--with self-serving anti-takeover legislation. The state law that governs the relationship of shareholders and management reflects the fact that state legislators, like corporate managers, have little accountability to shareholders, and the states have been shown to be powerless or worse in dealing with questions of abuse.

The Supreme Court's decision in the case of CTS v. Dynamics materially changed the rules in a manner that justifies, even requires, federal intervention. The SEC's Office of the Chief Economist has evaluated the impact of an Ohio antitakeover statute on the value of shares in 36 companies with headquarters in that state. The Ohio law depressed stock prices by an average of two percent, with losses ranging from $754 million to $1.45 billion. This refutes completely the arguments that antitakeover legislation benefits shareholders. It benefits management to the detriment of shareholders.

An explicit statement of federal policy would preempt undesirable state action. Federal legislation should establish minimum standards to protect the integrity and efficiency of shareholder voting. It could include a requirement of formal audits for the voting process (not just counting the ballots, but making sure that all of them are sent to and voted by the right people), and a "level playing field" for shareholder resolutions.

Conclusion

Once these impediments have been removed, we must set the agenda. Shareholders, as a matter of law and policy, must keep to a very limited set of issues. They do not have the expertise, the resources, or the right to get involved in matters of day to day management. Their only involvement should be to make sure that the interests of directors and management are aligned with the shareholders, and that when a conflict of interest is presented, that they make the decisions themselves.

Graham and Dodd, over a half century ago, described the agenda for governance activity, when they said that shareholders should limit their attention to matters where:

> the interest of the officer and the Stockholders may be in conflict. This field includes the following:
>
> 1. Compensation to Officers -- comprising salaries, bonuses, options to buy stock.
>
> 2. Expansion of the business -- involving the right to larger salaries, and the acquisition of more power and prestige by the officers.
>
> 3. Payment of dividends -- should the money earned remain under the control of the management, or pass into the hands of the stockholders?
>
> 4. Continuance of the stockholders' investment in the Company. Should the business continue as before, although unprofitable or should part of the capital be withdrawn, or should it be wound up completely?"
> (Securities Analysis, 1st Ed., at pgs. 510, 511 (1934))

I would add that governance must concern itself with preserving the full integrity--and value--of the characteristics of ownership appurtenant to shares of common stock. For example, the right to vote may be diluted by a classified board or by dual class capitalization, and the right to transfer the stock to a willing buyer at a mutually agreeable price may be abrogated by the adoption of a "poison pill."

These kinds of issues, not contemplated at the time of Graham and Dodd's first edition, can also present conflicts of interest, as shareholders are interested in accountability and officers and directors are interested in protecting themselves.

The next question is how to present these issues. At the Conference on Corporate Governance, Restructuring, and the Market for Corporate Control held earlier this year, Ira Millstein, Chairman of the New York Governor's Task Force on Pension Fund Investment and Chairman of the Institutional Investor Project at Columbia University, described an effective governance program:

> [P]ension funds would actively participate in proxy voting and corporate governance matters, using real economic growth over the long term as the guide. Because a short term orientation does little to improve an enterprise, the tendency for pension funds exclusively to "vote with their feet" -- the exit model of corporate governance -- would be complemented with a "voice" model. The voice model stresses the need to monitor the performance of corporations and when performance lags, to communicate with that corporation the fund's concerns. The communication should be moderate, hopefully private, and supportive to be effective. It need not be public, loud or hostile... But active pension fund management requires expertise, discipline and continuity, and requires proper compensation and incentives to attract and keep professionals who are capable of handling enormous assets, and dealing with the responsibilities those assets create.

In our view, the best way for stockholders to provide this moderate, private, and supportive communication to companies is through the board of directors, communicating about both its composition and its structure. By finding, nominating and supporting good candidates, by communicating with them while they serve on the board, and by voting them off the board if they are unresponsive, institutional shareholders can enhance value through governance. By devoting their attention to the structure that determines the relationship between shareholders and directors, they can make sure that the interests of shareholders and directors (and management) are aligned. Once that is ensured, shareholders can be confident that the day-to-day operations of the company will be in their long term best interest. Most companies provide for nomination of director candidates by shareholders. Institutional owners should avail themselves of this opportunity (there is no reason for this to be considered hostile by management); in order to be able to nominate suitable persons, it will be necessary to create and operate a central registry for willing and qualified nominees.[19]

Shareholder committees, to be funded by the companies, present an effective forum for these issues. Shareholder committees can communicate with the Board by raising issues and nominating directors, and with other shareholders, also by providing responses to management proposals, to be included in the proxy materials circulated by management. One possibility for federal action is the establishment of a self-regulatory organization for shareholders, along the lines of the exchanges. That would establish not only the mechanism but the justification for collective action.

In contemporary society, private decisions made by corporations affect everyday life no less, and arguably considerably more, than public decisions of governmental bodies. As two commentators noted not long ago, "By making ordinary business decisions [corporate] managers now have more power than most sovereign governments to determine where people will live; what work they will do if any; what they will eat, drink, and wear; what sorts of knowledge, schools, and universities they will encourage; and what kinds of society their children will inherit."[20] Who should participate in these corporate decisions?

Just as the system for representative democracy was established to provide a legitimate basis for public power,[21] the system of corporate governance was established to provide a legitimate basis for private power. Both are attempts to grapple with the problems that arise when increasingly complicated issues require the full-time attention of those especially qualified to attend to governance. Professional expertise is one kind of special qualification; qualities of virtue is another, more familiar in the classic defenses of representative democracy. Both qualities are cited as ideas for the representatives exercising assigned authority on behalf of the community, whether the community consists of citizens or shareholders. Management of day-to-day problems is both too difficult and too time-consuming if all interested persons retained rights to participate.

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[19] There have been encouraging efforts to form groups - among them The Committee on Investment of Employee Benefit Assets (CEIBA) of the Financial Executives Institute and the Council of Institutional Investors - to encourage collective action by institutions. Whether these, or new groups, should be encouraged and the extent to which they should be organized as self regulatory organizations under the 1934 Exchange Act are appropriate subjects for further study.

[20] Richard J. Barnet and Ronald Muller, Global Reach, The Power of the Multinational Corporations 15 (1974). This recognition of the enormous power exercised by private entities was also a main point of many Legal Realists. See, e.g., Morris Cohen, *Property and Sovereignty*, 13 Cornell L.Q. 8 (1927).

[21] See Michael Kammen, Sovereignty and Liberty 24 (1988); Edmund Morgan, Inventing the People (1988). For an elaboration of this idea and an alternate theory, see Joseph Schumpeter, Capitalism, Socialism and Democracy (3rd ed. 1950). His alternative theory emphasizes democracy as the method for selecting people to form the government who then must continue to compete for the people's vote. Id., at 269. See also Preface by Robert A.G. Monks for: Serving Two Masters: Contemporary Fiduciary Problems in

Thus, in both public governmental settings and large corporate settings, decisions about day-to-day management are delegated to designated authorities who have the expertise and time to focus on these matters. Precisely because of the reliance on assigned authority, another concept -- agency costs -- acquires pertinence for both governmental and corporate settings. In both settings, structures to assure accountability are necessary to guard against self-dealing by those delegated with the community's authority. Accountability is also necessary to guard against the other agency costs of neglect, or failure to pay adequate attention to the interests supposedly represented, and honest misunderstanding of those interests or how they would best be served. In some respects, the political model is useful here; in others, it is not. One concept that is pertinent in both settings is the notion of delegated responsibility.

Institutional shareholders can provide American companies with a solid infrastructure of capital. Pension funds can maximize long-term returns with investment strategies that benefit the corporations as well as the shareholders. Hostile takeovers and proxy contests are a last resort; given the opportunity to reduce agency costs through constructive involvement in corporate governance, the shareholders will do so. It is not just the best possible investment in the company; it is the best possible investment in the American economy as well.

The Wall Street Journal
January 24, 1989
Page A20

Buyers of Control Get a Lot More Than They Pay For

By Howard D. Sherman

What is the value of control? Economists, financial analysts, lawyers and political scientists often talk about the "control premium" as the difference between the market price of an individual share of stock and the amount it is worth as part of a block that controls the corporation. The price paid for stock in a takeover or a leveraged buy out reflects the value of control.

But the history of these transactions has shown us that shareholders lose out when control changes hands. In other countries, controlling shares typically trade for twice the value of other shares. In this country, because of the inefficiencies of the proxy system and the problems of collective choice, that has not been the case.

Investors often sit on value they do not realize – in both senses of the word. The parties to LBOs, management buy outs and hostile tender offers were the first to understand the value of control. It is easier for a few individuals to put together a deal than it is for a large, disparate group of shareholders to vote against it, especially when it includes a premium over the market price and there is no alternative offer on the table. Large institutional investors have been increasingly unhappy with the results, as it becomes clear that the people who buy control are getting a lot more than they pay for, and the shareholders who sell it are not getting what it is worth.

Three current events put this issue into sharper focus: the Bergen Brunswig Corp. recapitalization plan, the Samuel I. Newhouse Sr. estate tax case, and the unbundled stock unit proposals announced by Shearson Lehman Hutton last month.

• *Bergen Brunswig.* This New Jersey pharmaceutical company is doing something unprecedented, proposing to go from a dual class structure to a single class structure. Right now, the Class A shares are publicly held, and the Class B shares, which have the majority votes, are held by the two brothers who founded the company, Emil and Robert Martini. The B stock elects a majority of the board, and the Martinis can stop any attempted takeover. (The proxy statement acknowledges that they have, in fact, declined at least one all-cash offer for their shares, as well as overtures to undertake a leveraged buy out.) There has never been a clearer case for defining the value of control.

Financial analysts have suggested that the takeover price for Bergen Brunswig could be almost twice the price the stock is trading at right now. If the Martinis wanted to sell their shares, they would realize a substantial portion of that difference. At Resorts International, for example, the voting shares went for $100 a share more than the non-voting shares. Instead of selling to outsiders, the Martinis are going to sell to the shareholders by exchanging all of the B stock for A stock, at quite favorable terms, converting each supervoting B share into 9.5 shares of Class A stock. In exchange for an effective 11.6% dilution, the A shareholders will gain control.

Some analysts have claimed that the Martinis have placed an extraordinarily high price on their controlling B shares. The issue is not the conversion ratio – it is merely a byproduct of the number of B shares outstanding and the value of Class B as a whole. The only question is whether the price Class A shareholders are being asked to pay for control is worth it. It is the same question an outside bidder would ask himself. Compared with the 20% to 50% control premiums typically paid by outside corporate acquirers, the Bergen Brunswig proposal is a bargain. When the shareholders vote on Jan. 31, they should agree.

• *The Newhouse estate.* The Internal Revenue Service has shown that it understands the value of control in its assessment of the value of the controlling shares held by the Newhouse estate. This case, one of the largest estate tax disputes ever, is the flip side of Bergen Brunswig. The question is the same: how the various classes of stock of the family's principal business, Advance Publications, should be valued. The IRS is arguing that the 10 shares of Class A stock held by Si Newhouse Sr. were controlling shares and worth at least $420 million. The Newhouse heirs contend that the A shares were not controlling and were worth only $8.6 million.

The two sides will continue to argue the value of the A shares, but the IRS already established the essential point – that control shares are worth considerably more than non-voting shares.

• *Unbundled stock units.* Four major companies have announced that they intend to offer shareholders unbundled stock units in exchange for common stock. The offers divide the stock into three pieces, and none of them contain the right to vote proxies; that just disappears. Nowhere in the offers is there any mention of specific consideration for the loss of voting rights. These offers and the Big Board's related listing application may, for that reason alone, violate the SEC's one share, one vote ruling. But there are other problems.

The offers are directed at pension funds that, as tax-exempt investors, will not have to realize a tax gain by exchanging their shares. But pension funds are governed by the Employee Retirement Income Security Act, and the Labor Department has said that at least some proxy votes are assets of the plan. Can it be prudent under ERISA, recognizing the value of control as quantified in Bergen Brunswig and the Newhouse case, to relinquish the vote?

(Investors should not be misled by the fact that holders of USU bonds, one of the three units, would have the right to convert their securities into common stock and thus regain their voting rights upon announcement of a tender offer. Although this is a significant feature, the right to vote on a continuing basis – such as on takeover defense mechanisms that could make moot the provision just mentioned – is even more valuable.)

Until now, only one category of player seemed to have recognized the implicit value of control and common stock voting rights – the corporate raider. Through hostile takeovers, LBOs and proxy contests, the raiders have time and time again purchased or won control from institutional shareholders. The institutions have made some short term profits, but the raiders have been able to parlay their control purchases into much larger profits.

The Martinis are giving their shareholders the opportunity to get all of the control premium. The IRS is trying to tax the control premium. The unbundled stock units' sponsors are trying to appropriate the control premium. Shareholders should understand from these events that they have a substantial asset, the value of control.

Mr. Sherman is director of research for Institutional Shareholders Services in Washington.

Senator DODD. Thank you very much. Ned, thank you for coming down.

STATEMENT OF EDWARD V. REGAN, COMPTROLLER, STATE OF NEW YORK, NEW YORK, NY

Mr. REGAN. Thank you, Senator. I'll address the topics raised in your letter. The institutional setting of public and private pension systems, that's first.

Public systems are characterized by the governmental and sometimes political environment in which they exist, and by their civil service staffing patterns. They tend, therefore, to be active on matters of social and public policy and conservative and long-term oriented as investors.

Private systems are somewhat the opposite. Corporations tend to look at their funds as profit centers. Therefore, those funds are active investors and generally silent on public policy impacts of that investment.

Takeovers. Both types of funds, because of their large stock positions in corporations that are merging and limited positions in buyout funds, have been said to be involved in takeovers. Playing a much larger role in takeovers though are current under-valued corporate assets, business cycles, relaxed Federal regulation, financial incentives for corporate managers and investment bankers, new methods of financing and short-term investment patterns.

When these latter conditions change or possibly are altered by Federal action, the current wave of takeovers as we know it will cease.

Three, the role of managers and institutions as owners. The wide disbursal of stock and resulting separation of owners from managers preceded and coincided with the late 1960's and 1970's decline in productivity and business slump; and calls for governmental intervention; and calls for an industrial policy.

I was a member of the Presidential Commission on Industrial Competitiveness and Senator Heinz was very active with our group in those days. The reverse now seems to be true.

Owners are reasserting themselves as large pension systems monitor corporate activities and, of course, as many companies go private. This activity, the emergence of meaningful owners, parallels the current business resurgence and record-breaking period of recovery.

The way long-term institutional owners can fulfill their fiduciary obligation to increase share value is not to be involved with individual decisions of management over whom they have no power, but instead to monitor the activities of those over whom they can exercise influence.

The board of directors. A well-organized and functioning board with large owners having a limited option to comment on management's slate of directors in overseeing the activities of management is an owner's best guaranty of improving share value.

For Federal and State roles, well-run public and private pension systems that compete for a significant portion of every U.S. Treasury issue are in the national interest. They also create fiscal capacity at the State and local level through cuts in those Government's contributions, and with full funding of pensions, reduce reliance on the social security system.

Yet, State Governments pressure their systems to do below market rate investing usually in the name of local economic or social goals.

Also, State-sponsored South Africa and Northern Ireland divestment issues appear contrary to specific federal legislation.

I addressed myself to that 3 years ago to the Senate Foreign Relations Committee. Mr. Pressler was there at the time. In 2 hours of hearings, I discussed that issue.

In addition, States have legislated a system of de facto national takeover restrictions which could affect some future business cycle in as yet some unknown way.

Mr. Longstreth addressed himself to that.

Federal legislation suggestions.

First, a very modest tax on all stock purchases and sales rather than a tax on the systems themselves, as is done in other countries. Say, one-half of 1 percent. A securities transaction tax could have the beneficial effect of dampening speculation and encouraging long-term investing.

Two, Federal regulation. The direct application of ERISA to public systems; or less desirable, the passage of the Public Employee Pension Plan Reporting and Accountability Act, PEPPRA, which is the ERISA version for public systems, could ensure that public system investing will conform to high fiduciary standards and that those systems will remain strong members of national retirement patterns.

That's just a subtle way of suggesting that perhaps there are public funds that are willing to throw themselves into the arms of Washington to get away from their governors and legislators. A reverse of the normal pattern.

Finally, one might wish to look at the Metzenbaum-Armstrong Bill, Senate 1244, that would provide for limited shareholder access to corporate proxy statements and deal with some of the problems that once again Mr. Longstreth demonstrated.

The final section is just two or three sentences about our own system. My testimony does not discuss our own system but the above positions are reflected in our operations.

We invest long-term to provide retirement income to our 800,000 beneficiaries. We are a source of patient capital for U.S. corporations, have a very low stock turnover rate of 14 percent, own $12 billion worth of U.S. government securities, invest billions in job-producing activities while adhering to the highest of investment standards, have cut our government contributions to less than 5 percent of payroll—a record in the country, have not filed resolutions on matters of corporate governance and, yet, are implementing a program of monitoring boards of directors to see that they, the boards, improve the operations and share value of their companies.

We vote our proxies based on long-term economic criteria with advice from an outside committee and keep complete public records of all of our activities.

And I thank you.

[The complete prepared statement of Edward V. Regan follows:]

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER
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EDWARD V. REGAN
STATE COMPTROLLER

Testimony by
New York State Comptroller Edward V. Regan
Before the Subcommittee on Securities
U.S. Senate Committee on Banking, Housing, and Urban Affairs
October 3, 1989

I. INSTITUTIONAL SETTING OF PUBLIC AND PRIVATE PENSION SYSTEMS

Public systems are characterized by the governmental and sometimes political environment in which they exist and their civil service staffing patterns; they tend therefore to be active on matters of social and public policy and conservative and long-term oriented as investors. Private systems are somewhat the opposite; corporations tend to look at their funds as "profit centers" and therefore those funds are active investors and generally silent on public policy impacts of that investing.

II. TAKEOVERS

Both types of funds, because of their large stock positions in corporations that are merging and limited positions in buy-out funds, have been said to be "involved" in takeovers. Playing a much larger role in takeovers, though, are current undervalued corporate assets, business cycles, relaxed federal regulation, financial incentives for management and bankers, new methods of financing and short-term investment patterns. When these latter conditions change or are altered by federal action, the current ways of takeovers, as we know it, will cease.

III. THE ROLE OF MANAGERS AND INSTITUTIONS AS OWNERS

The wide dispersal of stock and resultant separation of owners from managers preceded and coincided with the late 1960s and 1970s decline in productivity, business slump, and calls for government intervention (an "industrial policy"). The reverse now appears to be true. Owners are reasserting themselves as new large pension systems monitor corporate activities (and as many public companies go private). This activity parallels the current business resurgence and record breaking period of recovery.

The way long term institutional owners can fulfill their fiduciary obligation to increase share value is not to be involved with individual decisions of management over whom they have no power, but to monitor the activities of those over whom they can exercise influence -- the board of directors. A well organized and functioning board (with large owners having a limited option to comment on management's slate of directors in the proxy statement), overseeing the activities of management, is an owner's best guarantee of improving share value.

IV. FEDERAL AND STATE ROLES

Well run public and private pension systems that compete for a significant portion of every U.S. Treasury issue are in the national interest. They also create fiscal capacity at the state and local level through cuts in those governments' contributions and, with full funding of pensions, reduce reliance on the national social security system. Yet state governments pressure their systems to do below market-rate investing usually in the name of local economic or social goals. Also, state-sponsored South Africa and Northern Ireland divestment appears contrary to specific federal legislation. In addition, states have legislated a system of de-facto national takeover restrictions which could affect some future business expansion cycle in as yet some unknown way.

V. FEDERAL LEGISLATION SUGGESTIONS

1. A very modest tax on all stock purchases and sales (rather than a tax on the systems themselves), as done in other countries, say one-half of one percent, could have the beneficial effect of dampening speculation and encouraging long-term investing.

2. Federal regulation -- the direct application of ERISA to public systems, or less desirable, the passage of the Public Employee Pension Plan Reporting and Accountability Act (PEPPRAA), could ensure that public system investing will conform to high fiduciary standards, and that those systems will remain strong members of national retirement patterns.

3. Proposed legislation, S.1244 (Metzenbaum, Armstrong), Sec. 8, provides for limited shareholder access to corporate proxy statements.

VI. THE NEW YORK STATE AND LOCAL SYSTEM

This testimony did not discuss our System of which I am Trustee (nor did the Cuomo Task Force Report). But the above positions are reflected in our operations. We invest long term to provide retirement income for our 800,000 beneficiaries.

As my testimony to the Cuomo Task Force and our two attached Annual Reports show, we are a source of "patient" capital for U.S. corporations, have a low turnover rate of 14 percent, own $11.6 billion of U.S. government securities, invest billions in job-producing activities while adhering to the highest investment standards, have not filed resolutions on matters of corporate governance and yet are implementing a program of monitoring boards of directors to see that they improve the operations and share value of their companies. We vote our proxies based on long-term economic criteria, with advice from an outside committee, and have kept a complete record of all votes for the past 10 years.

All investment and voting activities are done according to adopted procedures and policies that are strictly adhered to.

State of New York
Office of the State Comptroller
270 Broadway
New York City
10007

Edward V. Regan
State Comptroller

STATEMENT BY STATE COMPTROLLER EDWARD V. REGAN BEFORE THE GOVERNOR'S PENSION INVESTMENT TASK FORCE ON THE OPERATIONS OF NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS

MARCH 8, 1989

INTRODUCTION

This statement will cover pertinent topics mentioned in the Governor's January 30 announcement. It is based, in large part, on documents issued by my office.

The Retirement System represents $39 billion held in trust for 850,000 active and retired government workers. The system is part of the State Comptroller's Office. I am the administrative head of the system and sole trustee of these funds, and I am directly accountable to the public. I regularly and routinely report to our beneficiaries and the taxpayers in detail on our activities. Thus, everything discussed herein is already well documented.

The topics I will cover are:

- -- Investment practices
- -- Indirect benefits of pension system investments for the State's economy
- -- Long-term effects of pension investment decisions on corporate management
- -- The significance of accountability and responsibility for America's $2 trillion in public and private pension assets

In sum, I will document that our active and retired members' benefits are fully funded, our investment performance is superior, the contributions we require from state and local governments -- and therefore the states taxpayers -- are among the lowest in the nation, our investments contribute to the state's economy, infrastructure and job formation in multiple ways, our investments support long-term goals of American business and our proxy voting has been done for 10 years according to public policies, in part established by outside committees and is fully documented.

We welcome comparison of our investment performance with other public systems, especially those in this state, and comparison of our long-term economic and capitol formation performance with all systems, especially corporate pension systems.

Our achievements in all these fields are directly related to the fact that I am accountable to the public -- and to those that can influence the public, such as elected officials and union leaders. For eight years I have sought broaden and share my trustee responsibilities. On the other hand I will vigorously oppose any attempt to blur accountability, and let the decision making responsibility be smothered by an obscure board -- whose goals might not be consistent with providing ample retirements at lowest cost to taxpayers. Our record -- established over decades -- calls for no such drastic backward steps.

The topics I will not discuss, because of my desire to be brief, are state and national debt and the role of banks and corporate pension systems in some investment activities, that are mentioned in the Governor's announcement. I assume the Task Force is thoroughly reviewing these subjects.

INVESTMENT PRACTICES

Our investment practices are detailed in our 1988 Annual Report, which was previously distributed to members of the Task Force and those appearing before it. Those practices are guided and disciplined by law and constrained by our written procedures, external advisory boards and auditing organizations spelled out on page 16. The allocation of our assets, a discussion of each asset class, and the role of internal investment staff -- and outside consultants in the selection and monitoring of investments -- is discussed on pages 19 through 21. Our "business investment" class, which include leveraged buyouts, are expanded upon in a letter to the New York State Business Council, also previously distributed.

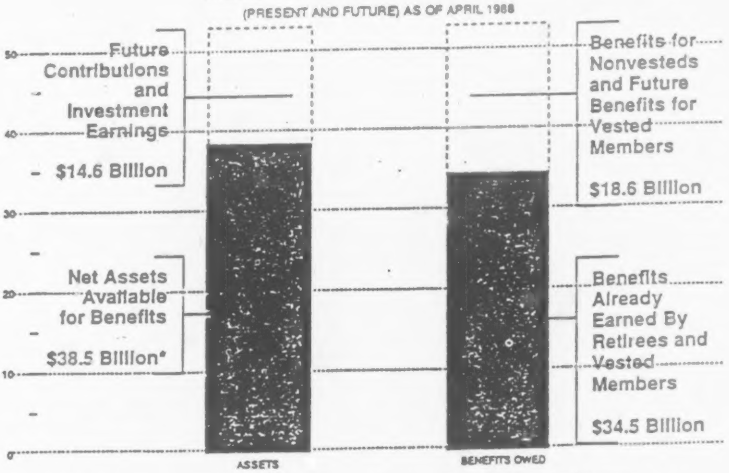
INDIRECT BENEFITS OF PENSION SYSTEM INVESTMENTS FOR THE STATE'S ECONOMY

On February 9, your chairman, Mr. Ira Millstein, testified before the House Committee on Education and Labor and spoke of a "need to modify ERISA [the federal statute governing corporate pension systems] and common law standards [to allow trustees to] consider factors that might indirectly benefit participants [such as] the health of the local or national economy." Trustees like myself are bound by those legal standards which require trustees to invest prudently for the exclusive benefit of members and beneficiaries. It is nonetheless possible to make investment decisions which meet these standards but also indirectly benefit taxpayers and the State's economy as our record illustrates. Therefore, while I do not discourage consideration and discussion of new laws, they may not be necessary in all instances. Our Annual Report clearly states that a major purpose of our system is "where possible to benefit the economy of New York State", and we do that in a number of ways.

First, we generate billions of dollars for use by elected officials for social and economic projects by keeping pension contributions from the state and local governments as low as possible. The Governor has stated repeatedly that to keep the state's economy growing, the State needs to cut taxes. My recent decision to continue adjustments in our earnings assumption -- and thereby reduce by $310 million this year's contribution by the State to the system -- provides the necessary resources to protect the next phase of the tax cut of more than $300 million. Local governments, on the other hand, might take their savings from the reduced contributions and channel them into infrastructure repair or business incentives to aid the economy. As our Report shows (page 10) we have significantly reduced government rates of contributions for ten years. Major reductions occurred in 1986 and 1987 that amounted to $450 million. We are able to do this because we are well funded and our investment performance has been consistently excellent. The Report (page 11) details our rates of return, such as a 12.2% return averaged over the past ten years and 14.1% average over the last three years. And as the chart below demonstrates, the present and future benefits of our active and retired members are secure:

VALUE OF ASSETS AND BENEFITS OWED

(PRESENT AND FUTURE) AS OF APRIL 1988



* Includes invested assets of $35.8 Billion and accrued contributions in the amount of $2.7 Billion, which are in the process of being liquidated.

Second, we aid the New York State economy with direct investment of billions of dollars in housing, office buildings, industrial parks and small ventures (see county-by-county breakdown on page 14 of our Report). Current projects include financing a hotel and office building to anchor downtown Brooklyn's new development, the AT&T building in Syracuse, 34 new loans to expanding businesses through the state's Business Development Corporation as well as projected investments through the Governor's Housing Task Force in moderate income housing.

Even greater benefit is provided through the billions that are invested in stocks and obligations of corporation doing business in New York. Forty-five percent of our investments are directly or indirectly in our own state -- a record we believe unmatched by any other pension system in the nation. (We believe a comparison of our economic accomplishments to those of the Task Force's sponsor, the Urban Development Corporation [UDC], would also cast us in a positive light.)

Finally, we aid the economy, as a major shareholder, by constructively monitoring the activities of the corporations in which we own stock. Our Investor Responsibility Committee, in existence for ten years, is composed of union and government officials, retirees and a private sector representative. It assists in developing policies and recommends votes on hundreds of shareholder resolutions each year. A second committee considers corporate governance and management resolutions. The policies of these committees emphasize the long-term economic impact of each issue on the fund. The procedures of both committees are detailed in the Report on page 12 and in the Supplement on pages 74-81. The system has a record of each vote cast, and the proxy information in our data base is called one of the most extensive in the nation. (By contrast, a recent national survey of 334 corporate pension plans indicated that 31% of the respondents did not know whether their proxies had been voted. Of those plans that voted at least some proxies, only 28% did so pursuant to written policies.)

Our efforts, with one exception, are not designed to question or try to second-guess day-to-day management decisions. That one exception is our anti-apartheid shareholder resolution program which has been instrumental in reducing from 167 to 48 the number of our portfolio companies with direct investment in South Africa. Our program is a more effective and responsible alternative to the perennial bill that would require us to sell $8 billion of assets over 18 months at a cost to taxpayers of at least $1 billion.

Our efforts have increasingly focused attention on Boards of Directors, the designated overseers of the management of the company. Our votes -- on resolutions emphasizing the need for outside directors and independent staffs, the existence of nominating procedures for directors, and fair pay and emoluments -- seek to encourage Boards of Directors to become more involved and to aggressively and conscientiously run their businesses for the long-term benefit of shareholders and the economy.

LONG-TERM EFFECTS OF PENSION INVESTMENT DECISIONS ON CORPORATE MANAGEMENT

American businesses' allegedly harmful, short-term investment practices were widely reported in early January as a major concern of the Bush administration -- "Bush Aides Study Ideas To Refocus Goals Of Business; long term view sought," said a front page headline in The New York Times on January 9. The Times article reported that corporate pension fund managers may think that ERISA requires them to take a short-term view. It suggested that investors and fund managers seeking quick gains discourage business executives from planning for the future.

Following extensive debates, an Assistant Secretary of the Department of Labor and the Deputy Secretary of Treasury said on January 30, that ERISA does not mandate a short-term view and that fiduciaries "may weigh the long term value [of a] company" in tender offer situations. President Bush recognizes that corporate pension systems need to be urged to adopt long-term investment practices.

Our system, on the other hand, is a leader in following long-term investment principles with its $33 billion stock and bond portfolio. We view ourselves (and have been cited by the New York State Business Council) as a source for patient capital for American industry, whose stock we buy and generally hold. The annual turnover rate on the New York Stock Exchange has zoomed to 73%, reflecting the active trading practices of many institutional investors, most notably corporate pension systems. We put no such pressure on American business for quarterly performance at the expense of long-term goals. This is reflected in our annual stock turnover rate of only 14 percent. Our bond portfolio trades even less, reflecting similar patience.

As further evidence of our long term commitment, we do not invest in synthetic or derivative stock products nor are we involved in any futures trading programs -- all of which involve rapid trading, short-term quick profits, and are thought to be among the causes of the October 19, 1987 crash, one of the subjects the Governor has asked you to explore. And our practice in corporate takeover situations is to monitor events on an individual basis and respond to tender offers at the last possible moment. This passive and patient strategy lends no encouragement to hostile takeovers.

THE SIGNIFICANCE OF ACCOUNTABILITY AND RESPONSIBILITY FOR AMERICA'S $2 TRILLION IN PENSION ASSETS

With the recent growth in the size and power of both private and public pension systems -- and their obvious potential to do good or to harm our economy -- many searching questions are being raised as to who, in fact, makes the investment decisions, and to which constituencies, if any, are the decision makers accountable. Recent emphasis on the issue of accountability has prompted a re-evaluation of who is the fiduciary of corporate pension plans. Consider the following:

> -- Last October Robert Monks, a former ERISA Administrator speaking at a national convention of corporate directors on "Corporate Directors are America's Largest Shareholders," surprised them by telling them that they -- not their pension fund managers -- had the ultimate responsibility for running their corporations' pension systems.

-- In a Colloquium sponsored last January by Columbia University's Institutional Investor Project, which I helped organize, discussions centered on the focus of pension fund investment decisions, and considered whether the identity of such decision-making needs to be removed from employees and money managers and returned to boards of directors.

-- In his recent testimony Mr. Millstein, your Chairman, told our nation's lawmakers that we may need a "standard to encourage plan fiduciaries to take back control over investment decisions at senior levels."

-- This Task Force has been charged with exploring the fiduciary structure, and presumably the location of fiduciary decisions, of the state's three major public pension funds. I assume that during the course of these hearings your inquiry as to how the trustee arrangements of the other two two systems in this state aid the taxpayers, the economy and America's long-term goals, has been searching.

Parallel to the broad reevaluation of the location of the fiduciary responsibility, I have been told that some corporations are, in fact, shifting the responsibility for pension investment decisions back to their directors. They are beginning to closely oversee investment and proxy voting practices of corporate pension systems. Directors are conscious of their accountability to the shareholders, who elect them, and society at large. As a result, there is no question in my mind that those systems will become better focused on the nation's economy and on the long-term effects of their investment decisions.

As sole trustee and an elected official, I am accountable, not only to the members and beneficiaries of our systems, but also to the taxpayers. I have long demonstrated that it is possible to be sensitive to issues of public concern and make prudent investment decisions to aid the economy. Our long-term investment and proxy voting practices evidence this fact. Our well funded status and superb investment performance also result from this accountability.

As sole trustee I have imposed a series of constraints on our operations. My staff and I have put in place elaborate policies and procedures, already referred to, which provide for both internal screenings and evaluation and we have hired consultants for each major investment area. I am also guided by five external advisory committees, and all these activities are monitored by four outside auditing groups. Nonetheless, for eight years I have sought to broaden the trusteeship -- in fact in the last two years my proposal on this subject has been the only one introduced in the Legislature. It calls for a small board of trustees, with the Comptroller as chairman appointing a majority of financial experts, subject to confirmation by the Senate, and protected through a constitutional amendment from precipitous change or dilution of the board. This approach would result in shared investment responsibility but yet preserve the accountability and independence that has meant so much to date and that experts cited earlier seem to feel is now required in pension systems.

CONCLUSION

I believe our investments respond to the needs of our beneficiaries, as required by fiduciary standards. They also benefit taxpayers, who ultimately make the contributions to the system. The assets are also a source of patient capital for American industry, promote long-term investment concepts and aid our economy. This is so, I believe, because I am directly accountable to, among others, the public for these activities. I do, however, look forward to receiving your suggestions.

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Senator **Dodd**. Mr. Feldman.

STATEMENT OF DAVID P. FELDMAN, VICE PRESIDENT, INVESTMENT MANAGEMENT, AT&T, BERKELEY HEIGHTS, NJ

Mr. **Feldman**. Thank you, Mr. Chairman, members of the Subcommittee. I am testifying on behalf of the Financial Executive Institute's Committee on Investment of Employee Benefit Assets [CIEBA]. We represent about $450 billion worth of assets in total.

I'd certainly like to second the expressions of support for the Subcommittee's investigation and hearings. I think these issues are extremely complex and could very well have far-reaching implications for corporate governance and the capital markets.

I feel strongly that any changes should be based on fact and not allegations. And, unfortunately, this is an area in which all of the facts are not readily available.

Piece-meal legislation is very bad legislation, so we're happy to see that you are taking the lead in bringing an overall approach to this because they interact a great deal in the marketplace, and our organization, certainly the individual companies which are represented, would be very happy to help in that process.

The pension system, private and public, has really become the single largest source of institutionalized savings in the U.S. today. I think we have a real success story to tell. It continues to be a growing and dependable source of capital for investment in the economy.

Since the enactment of ERISA in 1974, assets in the private sector have grown from approximately $200 billion to approximately $1.3 trillion today. And, even in Washington, I think that's real money.

In spite of, or perhaps because of our overall successes, attention has recently been focused on pension plans and how they're managed.

Very briefly from the perspective of one who has that responsibility, I would offer the following summary of our approach.

One, plan sponsors do not put pressure on money managers for short-term performance. We need long-term performance. We expect it. We do not look at quarter to quarter performance. We do not make hire and fire decisions based on short-term results. The average manager in the AT&T plan, for example, has been there well over seven years.

Pension funds are not monolithic. We differ in our liabilities, our funded status, our risk tolerance. As a result, the investment strategies vary widely and we don't all buy or sell together.

Active equity is only a piece of our total investments. I think this is a very important change that has come about largely because of ERISA and the diversification requirements that were embodied there.

Many sponsors have very substantial investments in equity index funds, which have essentially no turnover. Real estate, venture capital and other forms of non-traditional investments are similarly long-term in nature.

In the area of corporate governance, proxy votes are decided on the basis of what best serves the long-term interest of our beneficiaries on a case by case basis. All issues, including tender offers or poison pills, are considered against that standard.

We may and we have voted for or against management on all of these areas. The Department of Labor earlier this year issued another clarification. CIEBA itself testified as early as 1986 that we understood that we were not obligated to take the short-term viewpoint.

I don't doubt corporate managements are feeling pressure for short-term performances from many sources. Pension funds, however, are probably the longest-term investor or the longest term interest they have to deal with.

We are investing to fund liabilities that stretch 50 years and more into the future. In the 10 years I've had the pension fund responsibilities at AT&T, I have never been pressured to make an investment decision on short-run considerations. Nor have I exerted such pressure on others.

Finally, in terms of views on the proper role of institutional share-owners, I'll speak for myself here rather than CIEBA because we're 40 members and we have 40 viewpoints.

I think running a company is the purview of management. We shouldn't get in their way.

I also feel that some measure of watch-dogging by share-owners—all share-owners, by the way, not just pension funds—is an intrinsic element of the free enterprise system. Singling out pension funds in any legislation will not eliminate short-term pressure on managements and it also have a price.

By differentiating the rules of behavior for investors by differentiating, the workings of the free market may become distorted; and pension funds may become disadvantaged in the market. Less return on investment detracts from benefit security.

Mr. Longstreth stated that one of the realities for better or worse in the marketplace today is that they are global markets, and what's not done here can easily be done in London and Tokyo.

Pension plan sponsors share with the rest of the panel the desire to manage the money entrusted to us in the most effective way possible. We'll certainly be willing and happy to work with Congress toward that end.

Thank you.

[The complete prepared statement of David P. Feldman follows:]

SUMMARY TESTIMONY OF
THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS
OF THE
FINANCIAL EXECUTIVES INSTITUTE

October 3, 1989

The Financial Executives Institute's Committee on Investment of Employee Benefit Assets (CIEBA) is an association of corporate benefit plan sponsors with 40 regular members and about 150 advisory members. Collective benefit plan assets managed total more than $450 billion. CIEBA members -- who manage their plan assets on behalf of more than 6,000,000 plan participants -- speak from the vantage point of those charged with fiduciary responsibilities under ERISA.

The pension system, private and public, has become the single largest source of institutionalized savings in the U.S. today. Despite a savings rate in the U.S. that is widely felt to be too low, the pension system continues to be a growing and dependable source of capital for investment in the economy.

ERISA requires that pension fiduciaries invest that capital "solely in the interest of the participants and beneficiaries;" that is, that investment decisions must be made to provide the best possible assurance that the pension promise will be honored. Therefore, the overall fund return should be maximized subject to a prudent level of risk.

Recently, in discussions in various forums about investment and corporate governance issues, attention has focused on high short-term asset turnover among "active" money managers, or those who attempt to exceed overall market returns. *Some* of these managers (although certainly not all) invest on behalf of pension funds and, it has been postulated, trade more frequently because of pressure for short term performance from plan sponsors. This, in turn, it is contended, translates into pressure on corporate managements for short-term performance.

It is the belief of CIEBA members that most plan sponsors do not put such pressure on the investment managers they hire. We generally evaluate manager performance over a three- to five-year period or longer, and we do not make hire-or-fire decisions based solely on short-term performance.

Active investment manager turnover should not be used as a proxy for *pension fund* turnover. Pension funds are not a homogeneous group: they do not all sell at the same time or all buy at the same time. They differ with respect to their liability profiles, their funded status, and their risk tolerance. Their investment behavior and strategies necessarily differ as well.

Many sponsors are heavily invested in index funds; that is, they invest in funds that attempt to replicate overall market returns. These funds have extremely low turnover rates. They supply steady capital over the long-term, essentially ignoring short-term performance.

Many sponsors (certainly not all) also have some or all of their equity investments actively managed, in order to capture added value for the fund.

And, many sponsors are committing increasing amounts of capital to the private markets, such as real estate and venture capital. These investments normally are not traded actively or through the public markets at all.

For that portion of the assets that are actively managed, there may *or may not* be high turnover. And it should be noted that many of our members do not believe that active trading per se is undesirable for the markets. Active trading contributes to market depth and liquidity -- a hallmark of the American markets -- and to a lower cost of capital for corporations.

Corporate managements may well be feeling pressure for short-term performance, from *many* different sources. Most of us do feel such pressure: Congress, too, no doubt. Pension funds, in fact, are probably much less subject to short-term pressures than most: we are investing to fund liabilities that stretch 50 years and more into the future, in many cases. We are long-term investors, primarily for that reason, and we believe that ERISA is consistent on this subject: the interests of our beneficiaries would not be served if we were to pursue short-term gains at the expense of longer-term economic well-being. We hope that there will soon be some definitive evidence on the subject of private pension fund investment behavior from a project that the Financial Executives Research Foundation (or FERF) is undertaking.

On proxy voting issues, we make these decisions, or instruct our outside managers to do so, by attempting to determine what best serves the long-term interests of our beneficiaries, in accordance with ERISA. In takeover-related proxy issues, that may mean (for example) voting for poison pills, or it may mean voting against in other cases. When a tender offer is received, the decision is again based on the greatest long-term value: it may be found in the tender offer, and it might just as likely be found with the existing management. We *do not* favor one course of action over the other, nor are we required by ERISA to do so. The Departments of Treasury and Labor issued a joint statement last winter that supports this, and we are on record in other Congressional testimony as long ago as March 1986.

As required by last year's Department of Labor letter regarding proxy voting decisions, such decisions are made either solely by the sponsor, or solely by the investment manager who is managing the investment. If the sponsor does not reserve the right to make the voting decisions, it cannot interfere with the decisions of the investment manager, who will have been charged to vote according to the best interests of the plan beneficiaries.

UNITED STATES SENATE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

SUBCOMMITTEE ON SECURITIES

Testimony of

David P. Feldman
Corporate Vice President
AT&T

Testifying as

CHAIRMAN
COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS

of the

FINANCIAL EXECUTIVES INSTITUTE

October 3, 1989

TESTIMONY OF
THE COMMITTEE ON INVESTMENT OF EMPLOYEE BENEFIT ASSETS
OF THE
FINANCIAL EXECUTIVES INSTITUTE

October 3, 1989

INTRODUCTION

These observations are presented by the Committee on Investment of Employee Benefit Assets (CIEBA), which is a committee of the Financial Executives Institute (FEI).

The FEI is an association of approximately 13,000 financial executives representing some 7,000 American corporations. CIEBA itself has 40 regular members and approximately 150 advisory members, all of whom are corporate ERISA-governed benefit plan sponsors with collective assets that total more than $450 billion.

The corporations represented in CIEBA cover a broad range of industry groups and asset size. However, it is important to note that CIEBA members - who manage their plan assets on behalf of more than 6,000,000 union and non-union plan participants - speak from the vantage point of those charged with fiduciary responsibilities under ERISA.

These comments are presented to the Subcommittee to provide some background on the investment of pension fund assets and to comment on related issues under investigation by the Subcommittee.

PENSION FUNDS AND THE U.S. RETIREMENT SYSTEM

We believe that, as currently structured, operated, and regulated, the retirement system in the U.S. has been on balance quite successful in securing retirement income for U.S. workers. It has remained healthy through the best and the worst of times in the financial markets and in the world for fifty years and more, in some cases, and benefits are more secure today than ever before. It is estimated that the aggregate private plan asset to liability ratio stood at 1.38:1 in 1987, and only about 17% of private plans are estimated to have been funded at less than 1:1 in that year.[1]

This mark of success can be attributed to a number of factors: the tax law which allows assets to accumulate without a tax burden; healthy financial markets over the past several years; and prudent asset management and funding strategies on the part of plan fiduciaries, working under the governance of ERISA since 1974. Besides establishing standards for investment practices, ERISA wisely, in our opinion, gives plan sponsors the flexibility to have investment policies that can evolve with the markets, subject to prudent expert tests. As a result, sponsors have been able to enhance fund returns and improve diversification by investing in a broad range of financial instruments and investment opportunities, some of which did not exist in 1974 when ERISA was crafted.

In addition to its achievements in securing benefits, the pension system, including both private and public sector retirement plans, has become the single largest source of institutionalized savings in the U.S. today. Despite a savings rate in the U.S. that compares unfavorably with other industrialized nations, the pension system has continued to be a growing and dependable source of capital for investment in the economy.

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[1] Source: Employee Benefits Research Institute

Few countries in the world place the retirement income burden so heavily on the private sector as does the U.S., and thus far, the results speak eloquently for caution in considering any changes. We urge the Subcommittee to proceed with that thought in mind, and to *be alert in addressing the broader issues under investigation to the unintended implications for pension funds, in terms of both benefit security and general economic efficiency. It is crucial that policy in such a critical area as employee benefits not be made in a piecemeal, disjointed way.* Particular care should be taken to guard against unintended consequences or hardships for defined benefit plans, which are generally held to be most beneficial to participants.

THE PRIVATE PENSION SYSTEM: DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS

Corporate plan sponsors operate within a system of economic checks and balances that goes beyond the essential legal framework. It is created by the economic nature of the pension system itself. Corporate plan sponsors understand that economic prudence, not just legal prudence, on behalf of both the plan participants and the corporate shareholders, requires a careful and continuous assessment of the tradeoffs between the opportunity to reap investment gains and the risk of loss.

In defined benefit plans, the sponsor has a legal obligation to deliver a promised level of benefits to the participants. These benefits are paid for by a combination of corporate contributions and the earnings on the investment of those contributions, although the *obligation* to pay benefits is independent of the level of fund assets and earnings thereon. Employees generally do not make contributions to defined benefits plans. In 1987, defined benefit plans comprised approximately 27% of private plans, but accounted for 66% of trusteed private plan assets and, in 1985 (the most current data available), covered 72% of private plan participants.[2]

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[2] Source: Employee Benefits Research Institute

The plan participants and the corporate shareholders both benefit from investment policies aimed at maximizing pension fund returns subject to prudent risk-taking. For participants, higher fund earnings increase the security of benefits, and create less reliance on the corporation's ability to make future contributions. For shareholders, higher earnings reduce the amount they will ultimately have to pay to support a given level of benefits, and increase the dollars available to reinvest in the company's growth or to pay dividends. This, in turn, can help American companies in the aggregate be more competitive globally.

Similarly, participants and shareholders alike have a stake in controlling pension investment risk. If the value of contributed assets is decreased by investment losses, the participants will have to depend more heavily on future corporate contributions to secure their benefits. The shareholders will be required to pay more to deliver promised benefits, possibly detracting from the company's competitive position. *Ultimately, it is the corporation and thus the shareholder - not the participant - who bears the risk of inadequate returns or investment losses in a going concern's defined benefit plan.*

Many companies provide both defined benefit and defined contribution plans; some offer only one or the other. In a typical defined contribution plan, both the plan sponsor and the plan participants contribute specified amounts to the pension fund, and the earnings on those contributions are the only additional funds available for paying benefits. The participant, therefore, again stands to benefit from investment strategies aimed at maximizing return and controlling risk. The shareholder, although he has a less direct stake in a defined contribution plan than in a defined benefit plan, has an interest in prudent asset management because significant losses or relative underperformance would undoubtedly cause problems with employee welfare, morale, and productivity.

Aside from these economic considerations, which provide the strongest incentive for prudent asset management, it has been our experience that the overwhelming majority of pension plan managers live responsibly within the rules of all applicable laws and standards. In addition, through organizations such as

CIEBA, most pension fund managers are proactive in their efforts to foster and maintain ethical standards. *Since the enactment of ERISA, abuses by corporate sponsors have been rare.*

INVESTMENT OF PLAN ASSETS

ERISA requires that fiduciaries discharge their duties "solely in the interest of the participants and beneficiaries" and "for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan".[3] This requirement means that plan fiduciaries must make investment decisions to provide the best possible assurance that the pension promise will be honored; therefore, the overall fund return should be maximized subject to a prudent level of risk. The appropriate level of risk is determined by a variety of factors, including the plan's projected payout obligations, the extent to which assets already in the fund cover projected liabilities, and the ability of the corporation to make future contributions.

In the investment process, the first and most fundamental decision made is the asset allocation decision, or what proportions of the fund should be invested in various asset classes such as stocks, bonds, real estate, etc. The allocation decision is based on analysis of the risk/return characteristics of alternative investments, the correlations among their return patterns, the fund's liquidity needs based on anticipated contributions and payouts, and other factors. *The risk of the total portfolio is reduced by diversifying investments among and within asset classes, because judicious diversification serves to offset underperformance in some assets with overperformance in others. ERISA, in fact, explicitly charges fiduciaries to "diversify . . . the investments of the plan so as to minimize the risk of large losses . . .".*[4]

Some of the investments included in a well-diversified portfolio could be judged in and of themselves to have a relatively high element of risk. These kinds of investments can prudently be included if analysis of the factors listed above indicate a good fit with the rest of the portfolio and a beneficial effect on the financial health of the total portfolio. If the pattern of expected returns has a low correlation with other assets in the fund, the inclusion of such assets can increase the expected return of the total portfolio without proportionally increasing the total portfolio risk.

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[3] Employee Retirement Income Security Act of 1974 (ERISA), Section 404(a)(1)(A)
[4] Employee Retirement Income Security Act of 1974 (ERISA), Section 404(a)(1)(C)

LONG-TERM INVESTMENT HORIZON OF PRIVATE PLAN SPONSORS

After the asset allocation decision is made (or revised), the funds are committed (or shifted), either by means of "in-house" investing or through independent investment managers. *It should be emphasized that the asset allocation does not typically change significantly over the short term, and plan sponsors, governed by the long term nature of pension payout obligations, generally invest with a long term view.* Although liability profiles differ among corporations, sponsors are generally less concerned with short term movements in valuations of asset classes than with longer term expected returns of the entire diversified portfolio.

Recently, attention has been brought to bear on increased short term asset turnover among "active" investment managers (i.e., those who attempt to exceed the return level of the overall market), some of whom manage pension fund dollars and, it has been postulated, trade more frequently because of pressure for short term performance from plan sponsors. It is our belief that most sponsors generally evaluate the performance of their investment managers on a three- to five-year time horizon or longer, which suggests that longer term evaluations are the more general rule.

As noted above, pension funds differ with respect to their funded status, their risk tolerance, and their liability profile; their investment behavior necessarily differs as well. Pension funds do not all sell at the same time, or all buy at the same time. In addition, their equity investment strategies differ due to the factors noted above as well as to differing views as to the best way to achieve maximum returns over the long term.

Some funds are entirely indexed in their equity holdings; that is, they invest in funds that replicate the market returns. These funds have extremely low turnover rates. They are long-term suppliers of capital that essentially ignore short-term performance. Other funds attempt to outperform the market, or use a combination of both strategies. The latter case may *or may not* result in a high turnover rate. Active management does not necessarily translate into high turnover.

If trading volume among active managers has in fact increased, it is important to note that it does not necessarily follow that *pension fund* turnover has increased. There are recent trends in pension fund management that we believe would balance out an increase in active management turnover across the total fund. First, pension funds have substantially expanded their investments with "index" or "passive" investment managers, i.e., those who attempt to replicate the returns of the overall market. Trading activity in these accounts is initially non-existent. Second, pension funds have increased their investments in the private markets, such as real estate investments, venture capital, etc. Such investments are long term in nature and normally are not traded actively nor through the public markets at all.

It should also be noted that many of our members do not subscribe to the view that active trading per se is necessarily undesirable for the markets. Active trading contributes to overall market efficiency and investment liquidity, which adds to the attractiveness of an investment for most investors and to a lower cost of capital for corporations.

The Financial Executives Research Foundation (FERF) is undertaking a project to study the investment behavior of private pension funds. We hope that the results will add some hard evidence to the beliefs of our members.

PENSION FUND INVESTMENT IN LEVERAGED BUYOUTS (LBOs)

The 1980s have been a time of heightened corporate restructuring activity of many kinds, including divestitures, asset sales, mergers, acquisitions, and LBOs. Much of this activity, we believe, can be attributed to changes in the optimal mix of corporate assets and business ventures demanded by a rapidly-changing business and economic environment that is growing increasingly globalized and increasingly competitive. Another impetus, we believe, is an unwinding of some of the conglomeratization activity seen in the 1970s.

LBOs are long-term, illiquid investments, typically structured with a four- or five-year time horizon with only minimal returns, or none at all, expected in the early years. Contrary to conventional wisdom, LBOs are another kind of long-term investment that some pension funds engage in. According to our CIEBA member survey, about 30% of our members commit funds to these investments in an amount totalling approximately 1% of our assets. Sponsor fiduciaries who do invest in LBOs do so because they provide a high level of expected return and they enhance the return of the overall fund.

PROXY VOTING ISSUES

Although pension funds purchase equity securities for investment rather than control purposes, we are ipso facto owners of corporations as well. With ownership comes the responsibility to exercise ownership rights, including the voting of proxies. *In accordance with ERISA, these voting decisions, like investment decisions, must be made solely for the purpose of furthering the interests of plan beneficiaries. For a change of corporate control or other takeover-related issue, this requires approaching the decision with no bias toward either the existing management or the potential acquirer (if there is one), and maintaining continual study and analysis to assess where the greatest value lies.*

In a takeover situation, where a tender offer has been received, the same rules apply. We may tender our shares, or we may decide to hold on the belief that the existing management is most able to make profitable use of the corporation's assets. *We do not favor one course of action over the other, nor does ERISA require us to do so.* The Departments of Treasury and Labor issued a joint statement earlier this year in support of that view, and we are on record in previous Congressional testimony as early as March 1986.

As required by last year's Department of Labor opinion letter regarding proxy voting decisions, such decisions are made either solely by the sponsor, or solely by the investment manager who is managing the investment. If the sponsor does not reserve the right to make the voting decisions, it cannot interfere with the decisions of the investment manager, who will have been charged to vote according to the best interests of the plan beneficiaries.

Senator DODD. Thank you very much, Mr. Feldman. I appreciate your comments about the subcommittee's work. It's really our intention to proceed along those lines. I certainly don't have any preconceived notion about legislation in this area. But, we felt the most intelligent and thoughtful way to proceed would be to have really round tables like this to elicit the opinions and counsel of people who are involved in it.

There will be some difference of opinion as to what is occurring with regard to corporate governance and the capital markets. But that's the purpose for all this and I appreciate your recognition of that fact. My intention, shared by my Ranking Minority Member and colleague, Senator Heinz, is to proceed in a cautious and intelligent way so that we don't end up disrupting the capital markets.

On that note, we've had three new colleagues arrive since the discussion began. I'll turn to each of them and ask if they have any opening statements. Then we'll go to questions.

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, first, I would like to commend you on holding this hearing. It is, indeed, a very thoughtful and careful way to explore the issues of corporate governance as well as the perfections or imperfections of the marketplace.

I also commend you on having called such a distinguished panel of witnesses, a number of whom I've had the pleasure to hear before this Committee or in other forums previously.

I also want to apologize to this distinguished group for not being here for their statements. I had to testify myself, so I know how you feel. I had to sit there for a while on a panel. We were testifying on the President's proposal on the Clean Air Act. Otherwise I would not have stood you up nor my Chairman, Senator Dodd, who does such an excellent job.

This series of hearings explores the role of institutional investors in the capital markets and the corporate governance process. Some have observed that institutional investors dominate our marketplace and, apparently, you dominate our panel here today.

Institutional investors control $5 trillion in assets and 45 percent of all equity securities. They have become a major force, sweeping through our financial markets. Along with internationalization, institutionalization has been principally responsible for shaping our financial landscape in recent years.

The impact in our securities markets became most evident during "Black Monday", when program trading sent these giants rushing towards the exits on Wall Street all at the same time. Large block trading among institutional investors sends daily shutters through Wall Street where increased volatility has become a way of life.

As the major stockholders of American corporations, institutional investors are discovering what those in Congress already know: the importance of the right to vote. Institutional investors are becoming more active in the corporate governance process as they examine the alternative of voting with a proxy instead of voting with their feet. In turn, corporate management is recognizing the benefits of having investors rather than traders influence their company's destiny.

Mr. Chairman, there's little doubt that the actions of institutional investors do have and will continue to have a significant effect both on capital formation and the corporate governance process. Their decisions will, in large part, shape our economic future and our ability to compete in the global marketplace. It's important that we determine those legal, economic and political factors that influence the actions, or inactions, of our institutional investors and the direction those institutions are most likely to take.

So, Mr. Chairman, again, I commend you for holding this hearing and I thank our witnesses for being here.

Senator DODD. Thank you, Senator, very, very much.

Senator Pressler.

Senator PRESSLER. I want to thank you, Mr. Chairman, for organizing this fine hearing with such a distinguished panel of witnesses. We are holding another hearing on South Africa in the Foreign Relations Committee. I remember this the last time you testified on that subject, and I must make my presence felt over there.

I do thank the witnesses, however, and I will look forward to reading their testimony and the questions and answers.

Senator DODD. Senator Bond.

Senator BOND. Mr. Chairman, I thank you for the privilege of being able to sit in on this subcommittee, even though I'm not on the subcommittee. I think you and Senator Heinz certainly started the process of addressing a very important issue.

I'm delighted to be able to hear and read the testimony of these distinguished leaders in institutional investing. I, too, will have some questions at the appropriate time. And I thank you for the privilege of joining me today.

Senator DODD. We are delighted you were with us this morning. Let me begin. And I really want to encourage you to go back and forth here because I think it will be enlightening for us to hear some of you talk to each other as part of the hearing record.

Andy, let me begin with you. Then I'd like the rest of the panel to respond as well.

I said at the outset of these hearings that four of our panel members—the institutions and groups they represent—could really own your company.

Mr. SIGLER. They do.

Senator DODD. The firm of Kirby, Borges, Regan and Feldman. [Laughter.]

Mr. SIGLER. They're very powerful.

Senator DODD. Very powerful. Lots of money.

How do you convince these folks to provide you with the risk capital that you need over the long-term. That is the question I have for you.

And then, to them, my question is:

What does it take for you as the representatives of institutional investors to invest in a company and stick with it over the long term?

We've heard a number of suggestions today. Are there other things that should be considered? Is there something that should be changed within the corporate structure that doesn't require any kind of changes in tax law whatsoever to encourage holding investment for a longer period of time?

Based on the studies we've seen, there's one fund with a turnover rate of 300 percent turnover. With some, it's 10 percent; I don't want to suggest that it's all rapid. Three hundred percent is fairly high, obviously.

How would you respond to that?

Mr. SIGLER. There are a couple of comments I might make. First of all, I think it is absolutely essential that there be ownership control. I think any changes or any system that allows management off on its own is going to run into trouble. I think that's the first one.

The second point is that this is not a fragile system we're talking about. When we come down and say "If you do that, you'll cause another Black Monday," or "Everything will go," that's not true. I think this is essentially a very strong system and we adjust to change. We've adjusted to the fact that the institutional investor now owns us.

Now, what would we really like from owners?

We would like people who will listen to us, look at our record, and make decisions about whether to purchase based on what we say we're going to do. And then, most importantly, what we do.

That has a very strong pressure on what a management does. It's the ultimate pressure. And I think one of the things that I find frustrating is that in this whole group of witnesses, we're all so close together. I don't think there's any argument in describing the phenomenon that is going on. The problem is: where do you go from here?

And I don't think it's just a takeover issue. At least, I don't think that's particularly what we're talking about today. I think we're talking about the longer term direction—what makes me invest in paper mills in Alabama or not invest.

The takeover issue is a whole other ball game, although I think Bob Monks' suggestion on the tender issue is an extremely good one. The takeover issue seems to be grinding down, at least the bust-up takeover, as junk bonds become recognized for what they are, and investment decisions are changed.

That's a whole other world. I prefer long-term owners. What bothers me about indexed owners, indexed owners are there for sure, but there are two other factors.

One, the person who owns you owns everybody. Therefore, there is not a heck of a lot of interest in an individual company or concern for an individual company because the actual performance of one company if you own 470 out of the Fortune 500, is irrelevant.

There's very little personal about it and there's absolutely no investment decision there to be made.

Senator DODD. As long as they stay, what difference does it make to you?

Mr. SIGLER. OK. The ultimate then, Senator, would be if our owners were totally indexed, then I wouldn't have to worry about any of them. And I don't think that's right. There's a terribly positive thing about selling a stock. You know, if we could go out today and all be indexed right away, then the relationships between all stocks would never change. I think I'm right about that.

There would be no marginal difference driving stocks up and down. As I look at indexing, I totally agree with the comments made by a couple of the people here that indexes are good from an investor point of view. Why bother beating the market? Go to an indexed fund.

But, from an ownership point of view, it leaves an awful lot to be desired. I want ownership that cares about my company, that will either throw me out or really vote with me. Not just as part of a 400 company index.

Let me mention one other thing. We're now talking about owners getting more involved. I would ask you to look at the issues that fund managers are getting involved in. Very few have much to do with running the company. They're kind of generic issues. The funds pick out incidentally a dozen companies and propose confidential voting and other general issues like that on the proxy.

It's very frustrating to try to talk to our shareholders about those things. We're shunted off to someone who barely understands the issue.

So, we are looking for longer-term, larger shareholders that really care whether I'm investing, for example, in Alabama or not.

How do you change things?

I don't have any great answer. I like some of the ideas on taxes, whether it's a tax on transactions or a tax related to how long you hold. I don't think that idea should be thrown out.

I might add as a wisecrack, in listening to Mr. Feldman, I think corporations have proved that we're our own worst enemies. I mean, we belong to that group of corporate fund managers who are testifying for the status quo. I think, if I listen to all those words, he basically said we're doing a great job and we don't want any changes. And yet I think most top managers would come down here and say we'd go along more with what Bob Kirby said. We see lots of problems and we've got to deal with them.

Senator DODD. What you were saying in a sense, was that the danger of indexing, one of the dangers of indexation—is it reduces corporate accountability.

Mr. SIGLER. It could in the ultimate. Yes.

Mr. MONKS. Could I speak to that problem?

Senator DODD. We're going to give everybody a crack at it. I see that hands are going up.

Mr. REGAN. The answer, Senator, if I may, just open up your proxy statement. Let me comment on your slate of directors. And if I don't like what your directors are doing in overseeing the management of the company long term, then I would vote against those directors. And I would comment in your proxy statement asking other people to join with me to vote against your slate of directors if they're not doing the right job.

That's a way. Permanent holders. And my pension system is a permanent owner of Champion. We have the largest index in the nation, by the way. I consider myself a permanent owner but I want to establish the accountability that you asked for. I don't want to sell, so I would like to be able to discipline your board—not you. Your board—if they are not doing their job in overseeing the operations of your company on behalf of the owners, which are my 800,000 beneficiaries.

Mr. SIGLER. I have no problem with that at all. The ultimate vote is the vote for directors. I think it's the only one that matters.

I think the thing that bothers me is there is very little of the new activism that is particular to a company, although I will admit that the vote from your group has been a personal thing. By not personal, I mean the generic kind of proxy issues that call for "confidential voting," or one of those general, noncompany-specific issues.

Very seldom does the person we talk to even really know about the company, they say:

"OK, what list are you on? Oh, yes, we sent that one in with the other 25. Champion, do you make sweatsuits or spark plugs? Oh, you're in the paper business. I didn't know that. OK."

What we're looking for is personalized ownership.

Mr. REGAN. And that which we have just agreed with, that concept, although I don't want to put Andy in too much of a corner, but that concept is in the bill. The section of a bill I refer to in my testimony, sponsored by Senators Metzenbaum and Armstrong.

Senator DODD. Just the sponsors of that bill make it interesting. [Laughter.]

Mr. REGAN. But that's the kind of thing that we need. And, hopefully, that will come out of this discussion.

Mr. FELDMAN. One comment on the way we've gone at that, Mr. Chairman. I think the blend of active and passive management is one of the ways we've tried to deal with it.

The passive side is buy and hold. It's there because the company has performed well enough, has gotten to a size and stature that it's on somebody's index. And we have gone well beyond the S&P 500. AT&T owns about 1,200 companies. So I think there is a practical problem.

And my staff, I'm sure, would love to be interested on a company by company basis. But there simply isn't any way to invest the funds we have to do in that kind of fashion. So part of it is indexed, a very large part in our case—over half.

The other part, we give people like Bob Kirby, who do take a personal interest in companies and reflect whether a company is doing well or not so well on the actions within their portfolio. That's one of the reasons I think we have been able to do pretty well, having both involved.

But there are some practicalities involved. How active in one individual company you can get.

Senator DODD. I want to turn to my colleagues. I just have one question and it could be the subject of the rest of the hearing. Mr. Monks.

Mr. MONKS. Mr. Chairman, I want to talk a little bit about the nature of a fiduciary who invests in an index fund. As you remember, the pension funds are fiduciaries. When a fiduciary has made a decision to index, he, in effect, has said "I have given up the power to buy, the power to sell, the power to choose." In fact, the only relevant consideration from indexing fiduciaries is:

Is the company performing?

The Department of Labor, considering the appropriateness of indexed funds for pension funds, has said, "Look, you can't have a thoroughly bad company in your index."

You have to look at that. For the sake of illustration, let's say that Pan Am is not included in the indexes, even though by its size it might be, because people think its debt structure is too large.

The fiduciary, Mr. Chairman, has an obligation to consider the nature of the assets. He cannot sell out of a company whose performance is disappointing. The only activity the indexing fiduciary can take is exercise of ownership rights to encourage management to improve. When he looks at a barrel of apples and sees a poor apple, that's where he focuses attention.

What is necessary, Mr. Chairman, is a recognition that by having these assets in indexes there is need to create collective action vehicles. Even for Mr. Feldman with the largest private pension fund in America, as you heard him say, it is not economical for the American Telephone Company to inform itself about all of its holdings.

What this really means is that we have to create vehicles that permit research, which is the pattern in England. The National Association of Pension Funds, don't delegate the fiduciary power to vote, but they do have vehicles that act collectively.

It might well be, Mr. Chairman, that such a collective action vehicle could be authorized as a self-regulatory organization under the 1934 Act. It's clear that when you have 20 percent of the nation's stock owned in indexed funds, you've got to then go the next step and say:

How do we remove the obstacles to their being able to inform themselves adequately, and act collectively?

Then you have I think what Mr. Sigler is asking for, a significant bunch of shareholders and long-term holders asking the relevant questions.

Senator DODD. Yes.

Mr. SIGLER. I find myself kind of a token businessman. [Laughter.]

So I'll ask for more time.

There is one thing that bothers me on that issue, although I've got to repeat that from the point of view of an investor, indexing is very attractive. It's scary that AT&T owns 1,200 companies. It doesn't make you feel exclusive that you have AT&T as a shareholder.

Two things that bother me about indexing. One is how do you set the valuation of the stock as the indexes get bigger and bigger? Are you going to be satisfied to let it be set by that eventual very small percent on the margin driven by one person in Des Moines who buys 1,000 shares and all the indexes adjust?

I mean, that's a little frightening.

How do we really set value in our stock market?

And, in today's world, where we're dealing in a global situation with foreign currencies and the way we price companies, it's very cheap for foreign companies to come over here and buy anything they want, that bothers me.

And then, when you get into how do you deal with individual companies, the suggestion has been to create a bureaucracy that is going to decide who's good and bad. And that's pretty frightening because of the power of that bureaucracy. You're putting together the organization that's going to determine the direction of the U.S.

economic system. And I thought we were trying to get away from that.

Mr. **Monks**. The basis of my notion of having a collective action vehicle is that the preponderance of pension fund assets is controlled by large American corporations. Therefore, my notion is that the large American corporations, by creating a trust culture within themselves, would take the lead in setting the agenda and setting up such a collective action organization. It seems to me that the opportunity for them to set up the organization to which they themselves, would be accountable, would be irresistible.

Mr. **Borges**. Let me just chime in. I think, Senator, just a couple of observations I'd like to make.

First and foremost, I think that the entire argument of indexation is one that's pretty much, at least in my mind, one that most pension funds are going to do anyway. And they're going to increase. I don't think that that issue is all that relevant just because for those of us who are of substantial size, we pretty much are buying the index anyway and it's going to make an awful lot of sense, reduce transaction costs and a whole bevy of things to index.

I think the real issue is for us to look at and have a real examination of the nature of the relationship between owners, directors and managers. That's really what I think the bottom line situation for all of us is—a reexamination of the nature of the relationship.

On the one hand, I hear corporate entities saying we want to have active owners.

On the other hand, there are those who say leave us alone. Don't bother us at all.

But I think that the real issue for all of us and for this Committee to really examine is:

What should the relationship really be between owners, fiduciaries, management and boards?

I would like to submit that that relationship is changing, and I don't know where that relationship ought to be. But I think that in large measure is at the bottom line of many of the issues that we're discussing.

The other issue I'd like to just suggest is that I think that this morning we've heard statistics on both sides. There are those who suggest and suggest strongly that institutional holders are in for short-term gains, a tremendous amount of turnover.

We've also heard on the other hand from Ed Regan, an individual whom I respect, that he's had a turnover rate of 14 percent. We in the State of Connecticut 11 percent. I daresay that most of the public pension funds that I'm aware of don't have the turnover rates that have been suggested.

If there is one thing this subcommittee can do, it is to get a better handle on what the facts really are. And I think that an examination will suggest that institutional holders, long-term holders, it is important for us to stay in the market. We are the market. To the extent the market is unhealthy, we become unhealthy. And that, really, the focus ought to be on something that Ed has suggested, looking perhaps at some of the incentives that have caused corporate America and individuals to take excessive short-term profits.

I don't think there's been a single leveraged buyout triggered by Ned Regan, Frank Borges or any institutional holder.

But they have been triggered because we have a system in this country, mainly the tax system, that encourages it in large measure.

Senator DODD. No question about that.

I would invite you, Frank, to take a look at the study done by Dr. Brancato, done at the request of the subcommittee. I used the numbers of 300 percent and 10 percent just for the record. And the study will indicate that 300 was the high. The 10 was the low. The study shows that bank trust funds had the lowest turnover rates. Mutual funds and investment advisers had the highest rate.

I'll pull out the data and am more than willing for you to take a look at it. There is a lot of fluctuation.

Let me turn though to Senator Shelby, and I presume we can pick up.

Senator SHELBY. Thank you, Mr. Chairman. I think everybody here at the table would fundamentally agree. I hope you would. That who owns Corporate America are the shareholders.

Would you basically agree with that?

No dissent on that.

Mr. KIRBY. The only trouble is we can't find them.

Senator SHELBY. That's right. That's what I'm going to get at next. Wherever they are, if they own the shares, they own the company. Management doesn't own the company.

Is that agreed?

Mr. SIGLER. That's the law.

Senator SHELBY. That's the law, that's right.

Mr. MONKS. I may say also that that's a fiction. [Laughter.]

Senator SHELBY. It is?

Mr. MONKS. As a practical matter, the only way owners have to function is through the proxy system.

Senator SHELBY. Right.

Mr. MONKS. And the proxy system is completely disfunctional.

Mr. SIGLER. I disagree with that.

Senator SHELBY. What drives the market out there is the short-term profit. All of you have talked about that. Is the short term-profit.

But that's an attitude or an orientation. I know the Chairman of Champion has talked about orientation or attitude, but how do you change that attitude out there with so much money invested in the pension funds, I mean, assets in the pension funds of America and also mutual funds, and so little for equity owned by individuals, at least in their name?

It's going to be an attitude problem. And until you do that, do we do it here in the Congress by making public policy? By limiting what the pension funds, perhaps what the mutual funds can invest in? Or, how do we do it?

Mr. Monks?

Mr. MONKS. Senator Shelby, I only speak about the pension funds. In the case of mutual funds, there's a very different fact situation. With mutual funds, someone really is selling you a risk return ratio and instant liquidity. Someone says you want to get fast growth? And you say fine. You're just buying a hole in the sky.

So the mutual fund manager has a very difficult problem. He's got to stay highly liquid.

Senator **Shelby**. Or to stay in business.

Mr. **Monks**. But I just ask one simple question:

In aid of whom do we permit active management of equities by pension funds?

I can say one thing for sure. It is not in aid of the pensioners. Therefore, if it's not in aid of the pensioners, why are we running the system this way?

And if you are capable of taking 20-30 percent of the entire equity market and stopping it from being an "in and out trader" and your best people—like the Comptroller of the State of New York and is American Telephone Company and even the U.S. Congress are already doing it, you've already addressed the question.

Senator **Shelby**. How did the Japanese and the Germans compare with what we do? Is it by law, or is it by attitude?

Mr. **Monks**. The Germans and the Japanese have the same market system in which there are quotes setting a value for the company. However, they have a phenomenon of long-term holders who are not sellers. Yes, they're holders of stock but, no, they're not sellers in Japan.

Senator **Shelby**. That's an attitude rather than by law.

Mr. **Monks**. It's also structural, Senator Shelby.

Senator **Shelby**. By the banks owning it?

Mr. **Monks**. It's the banks owning in Germany, and I think it's Kairetsu who are the other members of the Zaibatsu group in Japan. Mitsubishi International owns Mitsubishi Electric, Mitsubishi Chemical. It doesn't make any difference what the market price is. Mitsubishi International is not going to sell their stock in Mitsubishi Electric.

So, by taking our pension segment and saying, look, we've got it, we have structurally what we need. Now all we have to do is simply to recognize that. And if nobody can provide a decent rejoinder to the question—"in aid of whom do we permit active investment for pensions?" We should stop condoning it.

Senator **Shelby**. Have some of our anti-trust laws gotten us in this predicament compared to Germany and Japan?

Mr. **Monks**. I think so. I think the legislative challenge is to remove the obstacles to the pension funds being able to be genuine long-term investors.

On the proxy side, there are a lot of problems.

Senator **Shelby**. Change of public policy, a change of law, and maybe attitude.

Mr. Sigler, you're rearing to go.

Mr. **Sigler**. Yes, because I feel that I'm trying to hold a position here. I think attitude is important, true, but attitudes are arrived at by the pressures of the system.

Today, you mentioned the half billion dollar investment by Champion in Alabama.

Senator **Shelby**. Which you wisely made in my State.

Mr. **Sigler**. And when we made that announcement, our stock went down 2.5 points.

Senator **Shelby**. That was because the people were not wise and not looking long-term.

Mr. **Sigler**. "Yes, there he goes again. He's looking long-term and he'll make a lot of money in two years. We might buy it again in 1994."

But, one of the causes of short-term thinking is the leveraged transaction by whatever name you want to call them; LBOs, takeovers, hostiles, restructuring, whatever. They are totally set up by the law and totally set up by the current rules, adjusting to changes, but influenced by the law and the rules.

That leveraged transaction is a fee-driven phenomenon. It is the means by which individual human beings have gotten richer than at any other time in history.

The LBO is kind of the final product. Before, it was others getting rich. Now management can get rich, too. Just read what the numbers of some of the recent buyouts in the airline business are going to do for management.

I think those are influenced by the rules. Now, the leveraged transaction is the threat that changes what a company can do. I can say I take a long-term look, but the fact is if I take too long a look and I don't produce, someone can come in and do whatever kind of a number on the company they want—sell the assets and take the company private.

So, if you want an attitude change, you'd better look at the leveraged transaction and the impact of that.

And that's all impacted by the current law and rules.

Senator **Shelby**. Haven't some people benefitted? I don't mean just a few. Haven't the mutual funds and the pension funds benefitted to some degree from the leveraged buyout?

Mr. **Sigler**. In the short-term, yes. That's the whole game they're playing.

Senator **Shelby**. It's a zero/sum game, isn't it?

Mr. **Sigler**. Yes.

Mr. **Kirby**. I'm the poor active investment manager in this group and I ought to try to protect my honor and my profession from Mr. Monks' terrible attack, from indexing the whole world.

There is great pressure on the active money manager to be opportunistic and it is darned difficult to resist. But let me first respond to Mr. Monks' attack.

He said who, why are active monies managed anyway? They don't go to the benefit of the participants in the plan?

There's an old saying in the money management business "You end up with the clients you deserve."

Here we have AT&T and the State of New York and the State of Connecticut have been clients of the trust company. If you don't mind a small commercial, we've been managing money for Connecticut for 18 years, and I think that has produced a superior rate of return, above the S&P 500 consistently over that period.

So, the State of Connecticut taxpayers have benefitted substantially because Frank and his predecessors hired us rather than indexed their money.

However, commercial over. When you get to the problem of what I call our buccaneer capital markets, we live in a world where, for better or worse, any guy in your neighborhood with a billion dollars who has the financial credibility to present a real credible assault can put almost any company in play overnight.

And if you go back to the situation where Marvin Davis and Northwest Airlines, he buys a bunch of the stock in the open market prior to making his takeover announcement. When he makes his announcement, overnight, he's got a $40–$50 million paper profit. The company goes up and all of the wonderful institutional shareholders of NWA are of course sitting in the background going whoopie.

We were big NWA shareholders and we went whoopie, too. But, you say to yourself, here, I thought I had a good, long-term investment. All of a sudden, I've got a stock that's in play and I've got to figure out what the arbitragers are going to do with it.

Shall I sell it at 90? Shall I keep it until 120? Or whatever. All of a sudden, you're no longer in an investment mode. You realize that a majority of the ownership of NWA has probably in the period of a week gone from investors to speculators and, well, you don't know how to respond.

In the Time/Warner situation, we were the largest shareholders of both Time and Warner. By far, owning 7–8 percent of each company. We thought that was a merger made in heaven and that it was going to create one of the really great companies that would be a wonderful 5 or 10 year holding.

And, all of a sudden, along comes Paramount and offers $200 in cash for Time and we're saying on the one hand we don't like this but, on the other hand, you have the chance to get $200 in cash for one of your holdings.

What we really wanted was for the merger to go through. We felt our clients would be better served by being major investors in that merged company over the next 5 or 10 years than they would be getting $200 in cash for the Time part and reinvesting it.

But, boy, fortunately, the problem was solved for us. But we would have had great difficulty. And I suppose would have driven our lawyers mad from the standpoint of our fiduciary responsibility if we had said no to the Paramount $200 cash tender offer, even though that's what we really wanted to do.

But, anyway, the ability of the active money manager to resist the siren call of short-term profits is really tough.

Thank you.

Senator SHELBY. Mr. Chairman, thank you.

Senator DODD. Senator Wirth, I know, has to go back to Armed Services.

OPENING COMMENTS OF SENATOR WIRTH

Senator WIRTH. Mr. Chairman, thank you.

Between Acid Rain this morning and the Armed Services Conference, I wanted to thank you all for being here. I have many old friends, and we've had this discussion for sometime. The longer I look at this, Mr. Chairman, the more I believe that we are not going to be able to influence the behavior of people who are concerned about making money for their shareholders.

Rather, our responsibility is to look at what incentives we provide for the short-term rather than the long-term. We are best advised not to try to jimmy with the behavior of these gentlemen and their corporations, but rather to look at the Tax Code, as you were suggesting earlier, the kinds of incentives that we build in there for short-term gain rather than the kind of long-term investment.

My hunch is that that's where our attention ought to be focused most clearly. In any case, particularly to Mr. Monks and Mr. Longstreth and Mr. Sigler, who have been involved with us for a long time, and to the others, if you have, thank you very much for being here.

Thank you, Mr. Chairman.

Senator **Dodd**. Thank you, Senator Wirth.

Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you. This is an absolutely fascinating discussion and I'm going to try to figure out a way to make it even more confusing than it already is.

I would like to add one other element to this. If somebody already mentioned this at the beginning I apologize because what I'm about to add is either profound or obvious. [Laughter.]

Senator **Dodd**. Or both. [Laughter.]

Senator **Heinz**. Let me express it in the easiest way for me, which is as a prejudice.

Most of what we're talking about today, with a couple of exceptions which I'll come back to in my time later, is really nibbling around the periphery of the central question, which is how do you structurally address the problem of incentives for people not to hold equities and to hold something else that's more profitable because it's easier for the corporation to serve it? Namely, debt.

I'm obviously referring to the fact that dividends come from after tax profits and are taxed again when they are received by the owner, the shareholder. However, interest paid on debt is deductible. So you have a tremendous bias in the Tax Code for shareholders to get out of equities and get into bonds with a higher yield up to a point because you often get what you pay for in the risk/reward area.

With debt you get a lot. You have a built-in incentive for people to convert equity to high yield junk bonds. It seems to me that unless we address that question one of these days, and it's not going to be this year, I can tell you that, that all of what we're talking about is just nibbling around the periphery.

Any comments on that? Yes?

Mr. **Longstreth**. I have a comment.

Senator **Heinz**. Mr. Feldman?

Mr. **Feldman**. I would say, Senator, from the standpoint of professional investors, the trend has been in the other direction. The focus has been much more towards equities and less on the debt side because, in the long run, we expect to make more money on the equity side than we do on the debt side.

Certainly in the junk bond area, you're looking at what may in many instances be called bonds, but are really going to work out to be some form of very high risk equity.

So I think from our perspective anyway, there has been and there continues to be a growing interest on the equity side because, in the long run, we're long-run investors, we're going to make more there.

Senator **Heinz**. The problem, of course, is, in the aggregate, equity is disappearing. There is less equity in the market today than there was 2 years ago before October 19th.

Mr. **Longstreth**. Senator, I think that's true if you're talking solely about the public markets, markets for public stock. But it is important to look at both public and private markets in evaluating what you see as some preference now for debt over equity.

I think, if you look at the private markets, which have been growing enormously, and look at the participants in the private markets through private placements of one kind or another, and I'm sure that the investors at the table who are participating in this phenomenon could talk to you about that.

Senator **Heinz**. In a sense then, are you saying that the cost of capital, which in this country is a mix of equity and debt and whatever else, is not a worrisome problem; that our capital markets are well-structured our cost of capital is not differentially high compared to our trading competitors; and that the cost of capital is irrelevant to the performance of corporate America?

I see a hand out of the corner of my eye from the one representative of corporate America here.

Mr. **Sigler**. You're right. The extraction of equity from the general economic system is immense.

Senator **Heinz**. So you think it's a problem?

Mr. **Sigler**. They still buy equity. But balance sheets of individual companies lean much less to equity than they used to. Part of that is the takeover issue. Part of it is the pressure on a company like Champion from institutional investors.

There's no way that Champion would go out or could go out and sell equity. The pressure on me is to buy back our stock, so we are pressing away from equity to debt.

Senator **Heinz**. Is that good for institutional investors?

Mr. **Sigler**. No, I don't think it's good for them, particularly in the aggregate. If we reach the Monk's Utopia, which, you know, I don't disagree with in lots of ways, where we're all indexed, then the only thing you're betting on is the long-term viability and success of the U.S. economic system. And the U.S. economic system is not being as successful as it can be, and it might become even worse if we don't look toward the ability to invest for the long-term.

Second, as I look at what our options are at Champion, can we build another mill? My debt/equity ratio is right at the reasonale limit. If I've got a lot more debt, I can't do those things. Debt is what drives the high-leverage transactions, obviously.

Now, greed is a factor also. When the deal is signed, all those people who have put together the package, have already made all their money. So there's no risk in that. They've made it through fees. But there are lots of other things that give debt advantages in those deals that really probably should be changed. Some of them have been changed, but leveraged deal—that's an area where debt is still very much more attractive.

Senator **Heinz**. Let me turn to another area, which is what you might call a governance issue.

I suspect that one could, at the risk of making an unjustifiably broad generalization, say that corporations get taken over when they aren't well-managed. I say that's overly-broad because there are some well-managed companies that have obviously succumbed to the problem we've just been describing on debt.

But, if there's any truth to that broad generalization, then why wouldn't it be appropriate for either indexers or any of you to say we don't have time to look into how a company is being managed. But there's going to be a presumption that unless a company has a majority of outside directors and that the nominating committee, which of course is the mechanism for coming up with the directors, is entirely composed of outside directors, we're not going to invest in them?

Mr. FELDMAN. I think AT&T could as an individual investor could support that.

Senator HEINZ. I'm not proposing any federal law. I'm just saying as a rule for you all, why isn't that a logical rule? The logic behind it, is that if you don't have the time to look, at least give the board of directors of the company a chance to look? If they're not in the majority and they're not truly independent nobody's looking except the management, which, if they're great management, terrific. If they're not, lots of luck.

Mr. LONGSTRETH. May I respond to that?

It's very important to recognize that someone is looking at the company that you've described. Let's assume it's a company in which all the directors are employees, are insiders. This doesn't mean that no one in a market economy where there is a market for control, this doesn't mean that no one's looking even if you went to a system of encouraging indexing by pension funds. People would be looking because——

Senator HEINZ. I didn't say that no one was going to be looking. On the other hand, if the contention is we want to invest for the long-term whenever possible, wouldn't your chances of having real time oversight of management and, therefore, the chances of prudent long-term management of the company be enhanced if you had that kind of linkage between the board and the management of the corporation?

Andy Sigler's over here saying that what he wants is a board that are going to hold him accountable. If you don't have somebody who is in that position, if the people who hold us accountable is us there are other dynamics that come into play. I just want to understand why you can't resist the siren song that I was singing to you there a moment ago.

Mr. LONGSTRETH. You made the suggestion that corporations that get taken over may in some cases, maybe in a lot of cases, be a reflection of poor management.

Senator HEINZ. I said that might be an overly-broad generalization. What I'm really interested in is the basic hypothesis that whether or not you think, on balance, it's healthy for a company to have a truly independent board.

Mr. LONGSTRETH. I don't think that when you get to the issue of control over the corporation, that the directors that we now have are independent in the sense that they can resist what I think economists call a "structural bias".

In the situation of the prototype public corporation where the independent directors are selected by the chief executive officer or by the nominating committee, which itself has been selected by the chief executive officer or by his predecessor, independent directors perform a profoundly important function of bringing independent judgment to bear on the employees in every context except a change of control situation. In the change of control instruction, I think that it is just quite normal to expect the tugs of loyalty, loyalty to management, which are commendable, to have an impact on judgment. And so I think if you want to preserve as a market discipline the opportunity to change control of a corporation, you really have to look elsewhere than the independent directors to expect that.

Comptroller **Regan**. Senator, we voted this year against every slate of directors in every corporation where there was a majority of insiders. I couldn't resist the siren song because we believe——

Senator **Heinz**. Why?

Comptroller **Regan**. I believe that we should not be involved with management decisions. Mr. Feldman is right. We do not have the ability to judge those decisions. We shouldn't be involved.

The board is accountable to us. Management is accountable to the board. The board is accountable to us. I believe the best way as quasi-permanent, long-term shareholders, the best opportunity for us to have increased share value to fulfill our fiduciary duty is to make sure there is a well-structured, well-functioning independent board.

So, about 10 percent of our companies have a majority of insiders and we voted against everybody there. We wrote every management first. We corresponded with them. Many of them wrote us back. They said we're right. One even wrote back and said, "We're in the process. We have just changed." There's very little disagreement on what we did.

So I think along with the nominating committee and some of the other things I've mentioned that is terribly important. And, again, what I would only like to have done is to be able to in the proxy statement, and we're now back to my initial testimony, for the proxy statement to be able to explain that to others that didn't do the research that we did about insider and outsider and just say: I'm casting my vote against management's slate because I believe there ought to be a majority of outsiders and I urge you to do the same.

Well, if we had that access, if I could get that one sentence in a corporate proxy statement, you would have all outsiders and you would have a majority of outsiders on every single company we invest in within a matter of months. There's no question about that in my mind.

So I think you're headed in exactly the right direction, channeling the pension system to the board. Let the board oversee the company. Let us monitor the board's ability to oversee the company.

And you have suggested some very good ways.

Senator **Dodd**. Senator Kassebaum.

Senator **Kassebaum**. Thank you, Mr. Chairman. First, my apologies for missing a large part of the testimony by trying to juggle another committee at the same time.

Just an observation following along the lines of Senator Heinz's question and the responses. I would think everybody would pretty much agree that that would be a very positive approach. I can't imagine anyone disagreeing, and I think that is important.

It takes a while to get that accomplished. I think you, Mr. Regan, and Mr. Borges, are both in positions as State Treasurers and are playing enormously important roles, and you obviously operate with a great deal of long-term vision and concern. I mean, you've got extra responsibilities there that lend, I would think, a different type of institutional outlook.

But, I've been concerned with what we can or perhaps can't do from this standpoint to aid in creating a different, or help create a different type of atmosphere; when since 1982, we have seen $400 billion in equity disappear and $800 billion in corporate debt accrue, we really have I think a situation that causes some alarm.

Now, how one finds an answer to it, I'm not sure. As you know, one small step I proposed was not an incentive but a disincentive. And I would gather from what everybody has been saying, that, basically, no one really does by intent engage in short-term investment.

So, if that's the case, I don't know why anyone would object to a fee that is designed just for six months or less investment in the market.

Comptroller REGAN. In my testimony, you did have to step out. I put myself in favor of a tax on the security, not a tax on the system. A transaction tax as such, as advocated by James Tobin and more recently by Larry Summers and his wife, of Harvard, in a very thoughtful paper on the securities transaction excise tax, which operates in other countries.

I have no problem with a good, solid exploration of that. I think I'd probably be in favor of it. I am concerned about a tax on the pension system as such, though we're such short-term investors, neither tax affects us either way, you're completely correct.

Senator KASSEBAUM. You mean your long-term.

Comptroller REGAN. We're such long-term investors. Thank you. Thanks for the correction. [Laughter.]

But I really don't want to see the system, the pension systems, taxed. You know, the camel's nose under the tent. After you responsible Senators have left and others might come in . . . [Laughter.]

And I get a little nervous that a tax on the transaction would accomplish your goals.

Senator KASSEBAUM. Let me just say in the taxation on transaction, that's an idea that has been floated in the Finance Committee and it's gone over like a lead balloon. So, there's probably less support for that effort than there might be even for a fee on short-term.

Mr. FELDMAN. Senator, I would share that concern, I think, in the broad area of taxing pension funds. As we've seen with both the social security tax and the income tax, they both started out very small and grew thereafter.

I think there is also a need for more exploration and more data. For example, in the tax expenditure area that is related to corporate pension funds, we're probably only about a sixth of the total, and twice as much is covered under defined contribution plans, which are monies the employees have put in for themselves, which would then be taxed and fleshed out.

So the corporate pension plans are a smaller piece of the total pie when you really begin to focus in on the figures. I would urge you to take a close look at that side of it.

Mr. BORGES. Senator, just in response to your question, I happen to have a viewpoint that opposes this taxation, whether it is the system or the gain. There are those occasions when funds do take capital gains, fairly significant ones. This usually happens after a stock has been pushed up because of some excess of some sort.

I really think that the attention should be focused more sharply on what Bob Kirby, or maybe it was Andy Sigler, referred to as the buccaneers of the industry, who really in my mind have caused a lot of these issues.

I think that, in large measure, to attempt to tax the public pension system is really in large measure trashing the victims.

We, in fact, are not with the individuals who initiated much of this activity that's resulted in some of the excesses. And I think Senator Dodd talked about it earlier, that some folks, eliminating the Tax Act, eliminating the kinds of incentives that cause individuals to put companies into play.

I had an interesting opportunity to read in Financial World recently what the top 100 Wall Street individuals involved in this activity gained last year in terms of fees and bonuses and everything else. And it was preposterous.

And I think that's really where the focus of attention ought to be. Most public funds that I'm aware of, and Ed's already talked about his 14 percent turnover rate, and I've talked about the 11 percent that we have, are long-term investors. We are the market.

Senator KASSEBAUM. Then you wouldn't be bothered.

Mr. BORGES. Not bothered. But I think, as Ed has indicated, I'm not so sure that that is where it ends.

Senator KASSEBAUM. Let me just follow on because we always get into this fear of a camel's nose under the tent. I have been a longtime advocate of general litigation product liability, and those who support that perhaps but fear the broader liability legislation say, well, this is just the camel's nose under the tent, or the National Rifle Association will say:

Well, that may be reasonable but it's just the camel's nose under the tent.

At some point, I think one does hope there are people here who recognize that it may be reasonable, but beyond that, there is some question.

So I really hope that if it has merit it can stand or fall on the merit of that alone rather than whether it might be the camel's nose under the tent.

Mr. BORGES. I think, if you take the issue . . . one of the concerns that I have and I'm sure some others is that some suggestion perhaps that this may be a revenue source.

Frankly, when you look at the size of the funds and the fact that they're doubling in size every 4 years, it's a significant amount of money. And there is some concern that there may be some element behind the whole idea of taxing it, associated more with revenue-generating than perhaps prohibiting an act that people are bothered by.

Mr. **Sigler**. I'd like to respond as a fiduciary of a company's pension fund.

I think you're on to something. I don't think you should be knocked back by these people. [Laughter.]

Mr. **Sigler**. We didn't invite to this hearing any of the type of people that we're talking about. We've got nothing but good, honest, long-term money investors in this room. But there are buccaneers out there because those numbers are bad on turnover. And all the games that the people in this room don't play—program trading and everything—should be looked at seriously and in terms of how you would tax it.

I'm not sure that 30 days or 60 days or whatever holding period is in your bill is the way. But I think the idea should be explored. I don't see any other way of getting after the short-term trading.

I hope that it would accomplish changes in investment behavior so that it would be revenue neutral. That's what bothers me about the transaction tax because no matter what you do in the ball game, you raise taxes. But I think there's something very solid to go on in your bill.

I do think that I would agree with Frank Borges that an area to look at is what are those leveraged transaction pluses that are gained in there?

It is unconscionable, the money that is made. That's what drives the deals. Good companies are taken over. Anybody can be taken over. You want to look at those things as well, but don't let up on the proposal to tax short-term gains. That one has merit.

Senator **Kassebaum**. Thank you, Mr. Chairman.

Senator **Dodd**. Thank you very much, Senator Kassebaum.

I wanted to come back to you, Mr. Longstreth, on some SEC related questions. But because we've just talked about taxes for a second, I think it may have been you, Mr. Kirby, where your initial statement talked about the possibility of something along the graduated capital gains line.

That debate will occur almost within moments here on the reconciliation bill, I presume on some form of capital gains tax or individual retirement accounts. I am tempted to ask you all what you think about that, but let me ask you what you think about the graduated approach.

Mr. **Kirby**. To me, I can't think of anything more obvious and non-controversial than somebody who has held an asset for 30 years. Maybe he's a farmer in Kansas and he wants to retire to Florida. That he should have to give up a third of its value to the Government because he sells it?

The idea that that represents anything close to income just kind of bolls me over. If you've held an asset for 3 days or 30 days, obviously, you're a trader and the results of that are some form of income and should be taxed close thereto.

Senator **Dodd**. But I thought I was the only guy that held this view about 5 years ago. I think you're absolutely correct.

Mr. **Kirby**. If you feel strongly and have a Robin Hood streak, then have the capital gains tax graduated two ways. The amount you take per year and the time you've held.

Senator DODD. There are many ways of doing it.

Mr. KIRBY. And if you want to be sure that rich people pay more taxes than poor people, have it graduated in the amount of the gain.

Senator DODD. But it's not a cliff. It is graduated.

Well, how do the rest of you feel about that? I'd be curious, starting with you, Mr. Feldman. Just a kind of quick response to that approach.

Mr. FELDMAN. I think the cut in capital gains would be positive.

Senator DODD. The one that is being proposed right now?

Mr. FELDMAN. Graduated. Any cut would be helpful. I think the graduated side of it for long-term investors, we'd be willing to live with that. It wouldn't be a problem for AT&T.

Comptroller REGAN. You've already heard my opinion as to the impacts on our system. I would prefer to see the transactions taxed.

Mr. MONKS. At the risk of being a one-note player, if I've got a choice between a way of inducing desirable conduct through taxation and some other way, I'd rather do it some other way. I feel that encouraging indexing of pension funds would accomplish that objective better.

Senator DODD. Mr. Longstreth, do you have an opinion on this?

Mr. LONGSTRETH. I do. I applauded the efforts of the Tax Reform Act to try to simplify the tax and make it more neutral. One of the major aspects of that was to take away the differential rates between capital gains and ordinary income so that we don't have to fuss over which is which.

So I'm appalled at the change that's being considered now, not only because of that, but because it's going to open the door—talk about a camel under the tent—it's going to open the door to increasing tinkering and differentials.

But, also I think it's amazing for the Congress to take that kind of a step if you look at the numbers as to who it benefits and who it doesn't benefit.

Senator DODD. Frank.

Mr. BORGES. I probably couldn't have said it more perfectly, what Mr. Longstreth was saying. I think the issue really comes down to who it benefits.

Senator DODD. Andy, do you want to comment on that?

Mr. SIGLER. I should disqualify myself as being in the timber business, we hold assets for 50 years. And I can draw the parallel to the farm example. We can't insure against our trees being blown down by Hugos and have that potential gain taken away from us.

I guess the way the tax system works is we tinker with it. And if we thought in 1986, even though some of you were involved in it, that we had put in the perfect tax bill, I think we'll find that that's not true.

My inclination, and it's a very strong feeling, is that capital gains helps the country. Forget who individually benefits.

Second, more refinement of the capital gains proposal and a graduation in rates based on holding periods is something I know we should be looking at.

Senator DODD. Let me change the subject slightly in all of this. We have a corporate leader here. We have institutional managers of funds. What's happened here? I could have asked before for someone on this panel to represent individual investors. That almost acronistic person who used to provide liquidity and stability in our markets, who seems to be going the way of the family farm and a variety of other things that were part of America's heritage.

What is the danger in all of this, Mr. Longstreth? We're talking about a growing percentage of our corporations being held by institutional investors. The individual investor did not come back after the October crash at all. There were some indications early on they'd come back but, clearly, they're still very uneasy about program trading and believe they're really not a part of this at all.

First of all, are we going to lose the individual investor?

Is this really a trend that's not going to be reversed? The individual investor is just going to disappear or play such a marginal role that he might as well disappear?

And if that is the case, what are the implications of that in your view?

I'd like to hear the rest of you on this.

Mr. LONGSTRETH. I suspect that the trend will continue. I think it's important to recognize what the trend means. What it means is they're not abandoning the market, either the market for debt or the market for equity. They're in the market. It's simply that they are farther removed from the decision-making process by which stocks and bonds or companies or marketplaces are selected.

Senator DODD. They don't have any influence on the governance of the corporations. I know they're in the market.

Mr. LONGSTRETH. But their money is being professionally managed. And often by people they didn't choose. And I think this is not necessarily bad because presumably they're being chosen by someone wise.

But what I think it means for securities regulation, for example, is that the triumphs of the 1933 Act which achieved amazingly important steps such as standardized accounting and full disclosure of material facts to investors, but which had built into it the notion that large, sophisticated institutions who could fend for themselves didn't need those protections, now, as we get to a marketplace which is dominated, overwhelmingly dominated, by institutions, you don't really need the kinds of protections that were built in there.

I think that, to a large extent, the institutions will be able to vicariously champion the rights of the individual investors such as remain.

I'm not now talking, by the way, about penny stocks and that sort of thing.

Senator DODD. You're anticipating my next question as well.

Mr. LONGSTRETH. What is important is that the government shift its focus to the whole set of mechanisms by which the beneficial owners of money for retirement and other purposes, have their money managed—the ways in which decisions are made which affect them importantly, in other words, questions of prudence and questions of conflicts of interest that may develop between many different interests that affect a judgment as to whether this manager is selected or that market is selected, and so forth.

It's very hard for us to disenthrall ourselves from the past success of the 1933 Act. But I think we need to do that.

Senator DODD. Let me ask Andy a quick one because I know he has a plane to catch.

Mr. SIGLER. My problem is I have to go exercise my responsibility as an independent outside director. And I don't want to be one of those awful people that Bevis was describing before.

Senator DODD. Will you comment on the individual investors?

Mr. SIGLER. I think any individual who jumps into the market in any other way than buying one or two stocks of companies he knows is crazy. The market is run today by people represented by this group here; there are hundreds and hundreds of young professionals sitting in front of CRTs at this very moment looking, watching and playing the game.

And if you're sitting here as an individual thinking that you can do it yourself, you're crazy. And I think we're going to eventually lose all individual investors. And I think it's bad.

I certainly don't know what the answer to that one is, Senator. But it's in the past.

Senator DODD. I understand that and we appreciate that.

Mr. MONKS. Mr. Chairman, I think that the increasing tendency toward institutional ownership will continue for reasons analogous to Gresham's Law, which you'll recall is bad money drives out good.

What we have here is a situation of tax aided savings driving out normal savings, and the Federal Government has created a system whereby one pattern of savings, like pension funds, IRA's and others, are entitled to such preferential treatment that, in fact, the policy acts as a siphon to channel savings in that direction.

Thus, you could really say someone had to be quite stupid to pay full taxes and use that as their savings when they could pay less than those taxes and accumulate them tax-free.

The catch of course in that is that, in order to be eligible for the tax treatment, you have to put it into some recognized institutional form of fiduciary. So, as long as we have this kind of system where we have two kinds of savings—tax-aided and the rest—you can count on an increase in institutional ownership as a percentage of the total.

The solution of what to do is relatively simply stated, Mr. Chairman. It is to anthromorphize the institutions. That simply means you have to make them more human. The institutions have got to be in a position where, as fiduciaries, they can and must deal with what the panel has described this morning, I thought very forcibly, of the responsibilities of ownership. Ownership isn't simply a right. It's a responsibility.

And the kind of thing that the law can do to be helpful here is to make clear to people that they do have responsibilities. If you go to even the most conscientious institutional owner, which for the sake of argument, I will say is the Comptroller of the State of New York, and you say, "Have I got a deal for you."

Senator D'AMATO. It sounds like a New Yorker. [Laughter.]

Mr. MONKS. Thank you, Senator D'Amato. I take it, that's a compliment. [Laughter.]

On the one hand, I could say to the Comptroller, I have a deal for you. You can sit back as owner of these securities and do nothing, absolutely nothing, and you'll collect just the amount of money.

But, you can spend Lord knows how much money and Lord knows how much energy to be a responsible institutional investor. He will say, "Well, am I going to make more money?"

I'm going to say, "Well, who knows? Are you going to sleep better?"

He'll say, "Yes, I'm going to sleep better. But why is this good for my beneficiaries?"

In other words, the problem we have is that the system is one which makes it extremely difficult for the individual to be able to justify costs that we know are for the benefit of the system as a whole.

I think the challenge for law makers is to create a system that removes the disincentives for people to act collectively and, therefore, to enable the common good to be pursued economically by individuals.

Comptroller **Regan**. Senator, I think, to answer your question, the movement to more institutional and less individual ownership has been healthy and can be made more healthy.

In the sixties and seventies, when we had stock widely disbursed, and no institutional holdings of any significance. We really had ownerless capitalism.

But that was not a time of great performance of American corporations. And I think it's not uncoincidental now that you have institutions monitoring corporate performance. Hardly in a perfect way, but at least they're knocking on the door and saying, "we're here." As owners reassert themselves, you have improvements in corporate performance in this country.

There are a lot of other factors in the economic performance of the 1960's, 1970's and 1980's, the focus on use of ownership rights to protect and enhance value is an important one. So, as I've indicated, if the institutional owner can responsibly and forcibly exercise fiduciary obligation to monitor the boards and let them know that they're there, that they will vote against a board of directors that is not performing the right way—and I've indicated we've done it in the past—and make sure the board monitors the corporation to increase performance of that corporation and make a more competitive market, that will benefit the economy. That starts with a responsible, powerful institutional investor, willing and able to work together.

Then the growth towards more funds in the hands of institutions, less admittedly in the hands of individuals, can be as it has been so far enormously helpful.

Mr. **Kirby**. I certainly would agree with Ned's point that we move from an ownerless corporate America because any individual whose ever tried to look at a proxy statement obviously would quickly throw up his hands, aside from the fact that the mailing service gets it to him two days after the annual meeting is over.

And I think the assumption that the individual investor has disappeared is a little bit misunderstood because he has really moved from being a direct investor to an investor in mutual funds.

As you know, the mutual fund industry is now almost a trillion dollars in and of itself. And here most companies that manage mutual funds like ours have at least half a dozen high-priced young MBA's who do nothing but read proxies at a given time of the year. And we make sure we get them on time, that they are thoughtfully considered, and that they adhere to kind of the principles we set forth.

So, while on one hand, I think institutional investors have been guilty of this vulturism of opportunism, of being willing to throw any company they own in a portfolio into the arena at 10 points above last night's close, on the other side, they have created a responsible sounding mechanism for management; whereas, Andy was saying, you know, maybe he didn't like it when they said we're selling your stock that you're going to build a $500 million plant in Alabama, but, obviously, somebody out there had a different point of view than he did.

And he heard it very quickly. Maybe it was solely opportunistic but, anyway, I think the situation is better rather than worse.

Senator **Dodd**. Senator D'Amato has joined us.

Al, we appreciate your coming by.

Senator **D'Amato**. Thank you, Mr. Chairman.

Certainly, I would like to pay my respects to our Comptroller, Ned Regan, who has done an excellent job as it relates to management of the pension funds of our State and having cut the costs down significantly to our taxpayers as it relates to the contributions that local municipalities and governments have got to make.

That's all taxpayer dollars, or a good portion of it.

And, of course, to our former colleague in Government, Commissioner Longstreth, who is now up there in the private sector earning a substantial sum so that he can help pay the taxes that make things go. [Laughter.]

Mr. Chairman, I would like to submit a statement for the record as if read in its entirety.

I'll make one observation as a person who has been over the years very much concerned that we not just simply come down against junk bonds, per se. The word junk bonds rather cast it in the pejorative. We've gone through that. And if you want to talk about them in an affirmative way, we call them high-yield bonds.

I think there has been a place, I think in many, many cases, in most instances, they have been a very productive tool for corporate America—not so much in the LBO's—but certainly as it relates to its use for those companies who are not AAA rated, Fortune 500 companies, and did and have raised capital and have produced results that have helped create this economic expansion and growth and development of jobs.

I'd be remiss, Mr. Chairman, if I didn't indicate that obviously it would seem that there has been a very real shortcoming, and in an area that I have been very protective of because it's important, I think, to capital formation and important to my State and to this Nation, the investment banking firms and Wall Street. Very important.

But, when we see the kinds of situations as it relates to the LBO's that have taken place, the Campeau situation, one is hard-pressed to understand how it is that respected financial advisors and banking firms could permit a situation where, through careful scrutiny, one would say:

Look, if you run the numbers, there's no way, given realistic yields, et cetera, that they're going to be able to pay the debt service, the debt, and continue their operations.

And I would think we had better take a look at whether or not some of the financial advise—and I know some of my friends on Wall Street might be somewhat annoyed by this—I don't think that they should be, at least those who are really doing their job. Are they more interested in fees than they are as it relates to giving good, sound advice?

I would think that maybe in certain areas, the lure of the large fees has obscured that which we have maybe taken for granted. And that is sound financial planning and advice.

I think that may be the case in too many instances. Certainly, I think this is something that we've got to look at.

Mr. KIRBY. That was a classic understatement of all time. [Laughter.]

Senator D'AMATO. Yet, for me, it's rather bold. I mean, it's bold.

Senator DODD. I'm shocked that they go after those fees.

Senator D'AMATO. Well, if it becomes just that they're going after the fees and that obfuscates the facts, then that's certainly I think a very real blow to the capital formation system of America. And it's something that we ought to look at very, very carefully.

Thank you, Mr. Chairman.

[The complete prepared statement of Senator D'Amato follows:]

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'AMATO. Mr. Chairman, the evolving position of institutional investors in corporate governance is yet another reminder of how rapidly the world of finance is changing. The securities markets on Wall Street have already felt many of these changes. The loss of individual investors, replacement of equity with debt and the shortage of new stock offerings have had a serious impact on one of New York City's bread and butter industries. In fact, it is estimated that 17,000 jobs have been lost on Wall Street since Ocotber, 1987. This naturally concerns me.

I know that the focus of these hearings is on the many broad ramifications of the enhanced role of institutions in the areas of finance, corporate governance and the economy. Mr. Chairman, I share your concern particularly as to the long term impact that short-term business thinking may promote. I will only note that our recent joint effort to improve America's personal savings rate is based on that same shared concern for this economy, which we are shaping today and which we will turn over to our grandchildren someday.

However, Mr. Chairman, I must also acknowledge my particular concern with the impact of these many new developments wrought by the institutional investor upon the stock exchanges in New York. I am hopeful that this hearing, or some other hearing, will be an appropriate forum for gathering information on this area of vital interest.

One last point I would like to make has to do with high-yield debt securities or junk bonds. I have long felt that the mere name "junk bond" does nothing to make this form of corporate finance any worse, nor does the high yield on these securities make them any better. Like any form of finance junk bonds are a useful tool in the right circumstance. Like any other tool, however, when used for the wrong task, the junk bond can do considerable harm to the machinery. We have long known that highly leveraged corporations face greater risks because of their dependence on large streams of cash flow. We have not known, however, of any way to identify at the outset of a leveraged buyout or junk bond issuance what level of risk such leverage poses to a given company.

Recent events have brought the message home that junk bonds are not the answer to every corporate financiers' dreams. They can indeed be the stuff of nightmares when used in the wrong situation. I look forward to the testimony of today's witnesses so that they, as representatives of the owners of half of corporate America, may enlighten us on the proper role of leverage finance and on the proper role of institutional investors in this complex financial world.

Senator **Dodd**. Thank you, Senator D'Amato.

Senator Riegle, chairman of the full committee has asked that a statement of his be included in the record. He very much wanted to come by this morning, as you know. Senator Sanford also has submitted a statement for the record.

STATEMENT OF CHAIRMAN RIEGLE

Chairman **Riegle**. Chairman Dodd, I want to say at the outset that I consider this hearing to be one of the most important hearings that will be held by either the full Banking Committee or any of our Subcommittees this year. At the full Committee we have held three oversight hearings on the condition of our financial and industrial base and this hearing I believe fits directly into that theme. Throughout my Chairmanship of the full Committee I plan to spend a significant part of my time examining way to improve the competitiveness of all sectors of our economy. This hearing directly relates to that issue.

Institutional investors today exert inordinate power and influence over the decision-making process of our publicly held institutions. They do so by the sheer volume of the number of shares they own and control. As a result, they directly affect the long and short term planning horizons of virtually all of corporate America and therefore the competitiveness of our institutions in an increasingly cutthroat international environment.

As recently as this past Sunday, the head of Sony Corporation wrote in the Business Section of the New York Times that "there is something fundamentally amiss in American industry." He noted America's loss of competitiveness in any number of different areas of high-tech manufacturing and said "it is a global concern that American industry regain its competitiveness."

His basic message was that "the United States Government and American companies should shift their time horizons." For this to happen, institutional investors, the principal owners of American companies, must also shift their time horizons.

Among Morita's many other observations were the following: "Investments are needed today that will pay dividends in 10, 20 or 30 years. Yet the financial community (in the United States) seems to concentrate on 10-minute time frames." "In the financial sector, now-nowism (as he calls it) causes currency fluctuations that undermine the future-oriented manufacturing industries and weaken the global economy." He states that "Because manufacturing is fundamental to a healthy economy, the most important role of the financial community should be to provide manufacturers with the best economic atmosphere." In another interview he points out that "America no longer makes things, it only takes pleasure in making profits from moving money around."

This may be an oversimplification. But it is very interesting to note Mr. Chairman, that at least one of our witnesses this morning, Mr. Robert Kirby will testify—and I believe that this is an accurate statement—that he believes that the essential role between the financial community and manufacturing sector—that Mr. Morita views as so important—is fundamentally out of kilter in this country. As, Mr. Kirby, puts it in his written statement, "The situation (in the United States) certainly limits the hope of establishing a cooperative relationship between a publicly-owned company and its institutional shareholders."

The fact is that the investing philosophy and strategies of our institutional investors are absolutely key to our future competitiveness. If corporate management and their large institutional holders ae not able to work together more harmoniously in the future the entire country will suffer. The importance of this working relationship cannot be underestimated, and Mr. Chairman, as you point out in your statement, the issues involved are not only complex but vital.

In summary, if the United States is to retain its competitive position in the world economy, serious consideration must be given at a minimum to:

1. Greatly improving the relationship and cooperative communication between institutional investors and corporate management.
2. Increasing the long-term investment horizons of institutional investors. Institutional investors cannot be so quarterly-oriented if we are to expect corporate America to engage in successful strategic planning for the next century.
3. Improving the accountability of senior management and corporate Boards of Directors for pension fund investment decisions. These decisions must not be delegated to mid-level personnel and must not be left without review and approval at the very top.
4. Clarifying the fiduciary responsibility of institutional investors to their constituencies. And,
5. Thoroughly reviewing the long-term implications to the country of doing nothing on these issues and preserving the status quo.

Chairman Dodd, I applaud you for beginning this debate and for your selection this morning of such an outstanding panel of witnesses.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator **Sanford**. Thank you, Mr. Chairman, and I thank you for calling for this hearing. I would also like to thank our excellent panel of witnesses for their thorough and frank testimony.

The subject before us today—the role of institutional investors in corporate governance and capital markets—is a complex and important one, both as it relates to the takeover and LBO phenomenon of the last decade and as it relates to our securities laws and the type of market they were designed to govern.

I have said many times that I believe that a major cause of the rampant wave of hostile, highly leveraged transactions that we have seen sweep across the country in the past 10 years is the result of the concentration of huge blocks of stocks and large amounts of money in the hands of a relatively small group of investors. It is this concentration of stock and readily available funds that has permitted companies to be put in play when the raider involved has put virtually no money down and has nothing to risk. As we have seen demonstrated all too vividly in the S&L crisis, our financial system does not seem to work well when those making the changes have particularly none of their own capital at risk.

Clearly the growing size of institutional holdings and the huge trading volume of institutional investors also brings into question our whole system of securities laws, disclosure requirements and the proxy process. Our system was designed for a time when shareholders were long term investors who put their money in a corporation for a precise reason. Arguably, management had more of a reason to listen to the demands of such shareholders than in today's world, where shares are traded constantly as part of program trades. When money managers become perceived as traders and speculators, not investors, it rasises fundamental questions about the what the rights of shareholders should and ought to be. Given the vast changes in our capital markets, I think it is essential that we look at just who votes "corporate America" and whether our current proxy voting system is appropriate. We may also want to look at whether the short-term investor, those holding stock for very short periods, should have the same voting rights as long term investors or whether some sort of holding period should be imposed before shares can be voted.

A number of the witnesses before us today have commented on the problem of the short-term focus of many institutional and corporate managers, and have put forward a number of ideas to address the situation. I am particularly intrigued by the notion of taxing pension funds for short-term capital gains and the idea of placing corporate raiders in the same position as officers, directors and 10% shareholders—treating them as "insiders" for the pruposes of the short-swing selling rules. The late idea was one I have suggested should be part of any takeover legislation the committee might consider, as I believe anyone who is about to put a company in play certainly has the most essential type of inside information imaginable. Asking such raiders to return any short swing profits made based on such information would go a long way toward deterring raiders from putting companies in play with no intention of actually running the company. It would again put some of the necessary risk back into the transaction, so that the raider isn't guaranteed to reap huge profits just by putting a company in play, yet would treat the raider no differently than other "insiders".

I look forward to greater comment on these and other ideas in our hearing this morning.

Senator **Dodd**. We've heard from other members of this panel. With two other, three other committees meeting simultaneously, it's difficult to get away.

I've got some additional questions here, many of which have had at least a partial answer. And I'm going to redraft the questions and submit to you as a panel—I'll try to make sure you don't all get the same questions. I'll get you the ones that pertain more directly to your own experiences and make them available to all of you because one of the things I've enjoyed here this morning is hearing you comment on each other's statements. It's been very helpful to this Senator anyway to hear that kind of a dynamic.

We did it a little bit different than how the Committee process normally functions here and how witnesses are treated, but I hope that you thought that it functioned well.

As you said earlier, Mr. Feldman, this is one of a series of hearings. We haven't answered every question today, but you've provided us with some very interesting ideas and have given us some very good, candid responses to various legislative proposals.

So it's really been a worthwhile hearing and your presence here, taking 2½–3 hours to sit here for am morning is something I deeply appreciate. I know you're very busy people, so we're looking forward to your response to those questions and an ongoing dialogue.

This subcommittee stands adjourned.

[Whereupon, at 12 noon, the subcommittee adjourned.]

[Response to written questions and additional material for the record follows:]

U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

ANSWERS TO QUESTIONS FROM MEMBERS OF THE SECURITIES SUBCOMMITTEE FOLLOWING THE HEARING ON OCTOBER 3, 1989

Robert A. G. Monks
December 27, 1989

1. For many years, the U.S. corporate system has been one in which ownership of corporations -- by public shareholders -- has been separated from control of those corporations -- by professional managers. The key question of corporate governance has been, "Just how do you align the interests of managers with the public shareholders?" It has been argued that takeovers serve that purpose, by weeding out managers who have not kept stock prices high for their public shareholders. However, some takeovers result in tremendous costs to employees, as well as to local economies. This leads to two questions. Does the fact that we have so many takeovers mean our other structures for accountability -- for example, use of the proxy process -- have failed? Is there a better way to structure our system so that the displacements that come from takeovers and forced restructurings are not necessary?

As I noted in my testimony, I believe that the economists who refer to takeovers as "market corrections" are right. But they are violent corrections, made possible--and profitable--by market failures. The collapse of the system of corporate governance has left management unaccountable to shareholders. That gives corporate management and raiders both the incentives and the opportunity for exploitation and abuse of shareholders. And that has led to this redirection of corporate energy and imagination toward takeovers and defenses against takeovers and away from productivity. This is only possible because an integral part of the contract between those who provide the capital (shareholders) and those who provide the labor (corporate management) has all but disappeared, due to rampant inefficiency and abuse in the most important mechanism for shareholder communication--the exercise of ownership power and responsibility, primarily through voting of proxies and valuating tender offers. If it was restored, the market would permit only those mergers and acquisitions that benefit all parties. Our other structures for accountability have not been successful enough to permit that to be the case.

David A. Walker, former Executive Director of the Bank of England, best summarized the dilemma faced by an institutional shareholder who must decide whether to sell the stock in a takeover or to become actively involved in the corporation's governance[1]:

> "[31]... One reason for the failure of shareholders to put pressure on the board of a sub-performance company ahead of takeover situations is the free rider problem - that is, the reluctance of one shareholder to take a difficult initiative of which the fruits, if it is successful, will have to be shared with others who bear no part of the cost. Another is the observation over a long period and on both sides of the Atlantic that selling shareholders secure a substantial improvement in capital value on realization whereas the shareholders of the acquiring company tend to fare less well. [32] This combination of the free rider problem and the experience of large gain through assenting shares in bid situations provides institutional shareholders with an awkwardly strong disincentive to take time-consuming and difficult initiatives with the boards of their companies or to enter even into informal commitments as to the firmness of their holdings. Institutional shareholders have a rational reason for waiting, like Mr. Micawber, for something to turn up."

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[1] David A. Walker, Finance and Industry: Conflict or Complementarily, Inaugural Bridge lecture to the Worshipful Company of Engineers at the City University Business School, on Wednesday, 17 February 1988.

Ira Millstein well states the challenge in America for change through ownership involvement: "The issue is, then, whether we have the means within our existing corporate governance systems to change managements that are not sufficiently competent and are not running sufficiently competitive enterprises, or, at least, to change management courses for the better. In my view, we don't have to change ownership to do it. But we do have to use the governance structures already in place to achieve real accountability and credible monitoring of managements. Enter the institutional shareholder."[2]

A "proxy" based governance system is substantially different from one based on takeovers. First, ownership expressed through voting depends, first and foremost, on persuasion. Second, a voting choice, even if unsuccessful, is not definitive about the relationship with a company. Finally, ownership "voice" permits the expression of all range of opinions.

Needless to say, the present system presents substantial obstacles to effective expression of proxy-based governance. But the necessary changes to the proxy system and other structures for accountability are neither massive nor complicated. The major obstacle is the inability of shareholders to join forces in "collective action." No structure exists to permit the economical group-expression of ownership concern, even by the largest shareholders. As a matter of economic and fiduciary responsibility, they simply cannot volunteer resources disproportionate to any expectable return.

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[2] Ira M. Millstein, "The Responsibility of the Institutional Investor in Corporate Managements," Solomon Brothers Center for the Study of Financial Institutions, May 29, 1989.

Two developments are necessary: an explicit standard obligating fiduciary shareholders to discharge their responsibilities as owners, and a structure to enable shareholders to act rationally when discharging these responsibilities. These are the building blocks of a sound corporate governance system.

The first requires a clear and unmistakable message stating that shareholders are not just permitted, but obligated to be active and responsible investors with regards to corporate governance. The Labor Department has made significant progress with regard to fiduciary shareholder's covered by ERISA, but this message must be unequivocal and universal.

The constructive involvement of owners must come to be recognized as a "best practice" and in the interests of all, not just to themselves through increased values, but also to management through an accountability system based on dealing explicitly with their chosen partners and to the public by providing a legitimate basis for private power.

At present, the situation is confused. On the one hand, owners often feel a negative economic incentive to act; on the other, they feel there is little chance of meaningful punishment for failing to vote. What damages could be demostrated? In the case of fiduciaries, the problem is easily solved. The appropriate regulatory authorities can make it clear that failure to act as owners of portfolio companies is sufficient to disqualify an institutional owner from the privilege of serving as a fiduciary. Just as managers would expect to be disciplined for negligence in the exercise of prudence in purchasing, selling or holding securities, so should they come to expect comparable scrutiny and accountability with respect to ownership responsibilities.

A change in compensation structure will encourage a change in attitude and obligation. The structure -- perhaps resembling "derivative shareholder" litigation -- must be adopted to enable owners to act "rationally" when discharging their responsibilities. The possibilities of owners being reimbursed for their costs incurred in the quest for enhanced corporate values need be carefully investigated. There continues to be some question as to the legality and propriety of collective action by owners[3] which needs to be put to rest. Ultimately, reluctance over having voting power concentrated in a few collective action groups may result. Congress may want to explore the possibility of authorizing Self Regulatory Organizations for this purpose

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[3] See Alfred F. Conard, **Beyond Managerialism: Investor Capitalism**, 22 U.Mich.L.R. 117 (1988).

("SROs") under the Securities and Exchange Act of 1934.

Above all else, it is essential for government to make an explicit declaration of policy encouraging -- not requiring -- the involvement of owners in the governance process. As a signal of federal intention to effect a change in the existing governance climate, "[t]he control of business enterprises by their shareholders, including their institutional shareholders, should be declared as a purpose of each of the laws that govern securities, employee pension and benefit funds, mutual funds, foundations and other institutional investors that are the subjects of federal legislation. The purpose clauses of these laws should be expanded to articulate this objective."[4]

2. The SEC last examined the question of corporate accountability in a staff report issued in 1980. In light of the dramatic changes in the market over the past decade -- e.g., the growing ownership of equities by pension funds, increased private placements and other private investments, increased takeover and leveraged buyout activity, the adoption of "poison pills" and other defensive tactics, and developments in state law relating to change in control situations -- should we ask the SEC to undertake such a study again?

Yes, we do need a detailed and high-level study on the capacity of institutional owners to provide an acceptable basis for the governance of American corporations. But while the SEC has particular expertise in the area of securities regulation, governance issues must not be confined to existing departmental jurisdiction. A specific

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[4] Conard, op.cit.supra at 178.

Congressional directive is needed in order to endow any study with legitimacy -- it must not be viewed as an effort of a particular agency to expand its own power --with necessary involvement by the private sector and with appropriate funding, staff and accountability.

At the behest of the Senate Banking Committee[5], The SEC was charged to create an Advisory Committee on Tender Offers. In effect, this granted the SEC with a broad mandate to delve into the whole area of governance. The result was a remarkably talented and hardworking committee under the Chairmanship of a leading institutional investor, Dean LeBaron, which produced a timely, detailed and specific report on July 8, 1983. Yet nothing ensued as a result of this effort. Thus, it becomes clear that the question needs to be addressed by a wider constituency -- involving several government departments, institutional investors of all categories, and the public -- with a specific mandate from the Congress and the Executive branch.

Corporate accountability is the relationship of management to owners. It is simply a matter of discharging the appropriate responsibilities of ownership. Understanding of this relationship is best found through an analysis of the largest owners, meaning the various classes of institutional investor. The questions relating to corporate accountability, therefore, might best be explored by a legislatively mandated ad-hoc task force ("Governance Task Force"), consisting of representatives from:

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[5] Letter to Chairman Shad, 2/1/83

(A) The most important categories of institutional investors (Private pension funds, bank trust departments, mutual funds, Insurance companies, private foundations and endowments, etc.)
(B) Their regulators
    (i) The SEC (due to its authority under the Investment Company Act of 1940 over mutual funds)
    (ii) The Department of Labor (due to its authority over ERISA and private pension funds)
    (iii) The Federal Reserve Board and other appropriate bank regulatory agencies (due to authority over banks acting as trustee)
(C) Representatives of non-federally regulated institutional investors (the publicpension systems and TIAA/CREF, for example)

3. For many years in this country, our markets have been characterized by broad, public ownership. That ownership has rested primarily with individual investors. Individual investors have been an important source of stability, as well as liquidity. Perhaps just as important, when individuals own stock, they feel they have a stake in our capitalistic system and in the success of our economy as a whole. Will there be a place for the individual investor in the markets a decade or more from now? If individuals hold shares primarily through institutions, should we try to keep them involved in the corporate governance process? Or should we relegate corporate governance to the professional money managers and institutions? Do we need to develop a different structure?

The typical shareholder of a modern large business enterprise is different from the owner of tangible property: the ownership of the former is both indirect and temporary. Treating the shareholder of a large modern corporation as if he were a traditional owner entitled to legal protection of his unique right of property fails to consider the gradual change in ownership over the last fifty years from the direct and permanent to the indirect and temporary.[6]

Ownership of property involves responsibility. An owner of tangible property is required to avoid causing nuisance to others. Yet the extent of shareholder responsibility has been obscured by the corporate form of organization. "The capitalist process, by substituting a mere parcel of shares for the wall of and the machines in a factory, takes the life out of the idea of property. It loosens the grip that once was so strong - the grip in the sense of the legal right and the actual ability to do as one pleases with one's own; the grip also in the sense that the holder of the title loses the will to fight, economically, physically, politically, for 'his' factory and his control over it, to die if necessary on its steps. And this evaporation of what we may term the material substance of property -- its visible and touchable reality -- affects not only the attitude of holders but also that of the workmen and the public in general. Dematerialized, defunctionalized and absentee ownership does not impress and call forth moral allegiance as the vital form of property did. Eventually, there will be nobody left who really cares to stand for it - nobody within and nobody without the precincts of the big concerns."[7]

"Ownership" of large corporations, whether by small individuals or by large institutions, bears little resemblance to the traditional connotations of the word. The traditional owner has no counterpart in the governance structure of the modern corporation. The sense of personal involvement seems to have vanished. However, "ownership" as a legal concept with the practical capacity of effectively holding management accountable for its stewardship can be recreated. What is required, however, is a consensus that such is necessary, desirable and legal. Thereafter, a structure that permits "rational" -- that is to say self-interested -- involvement by owners of any category or size is needed. One way of achieving this would be the creation of Permanent Shareholder Committees[8] where companies (therefore all shareholders on a pro rata basis) would pay for a mechanism enabling ownership concerns to be directed to managements. Such a structure would be available to individuals as well as institutions.

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[6] Hurst, at 104

[7] Schumpeter, Joseph, Capitalism, Socialism and Democracy, Harper and Row, 1942, at p. 142

Thus, one can see that the shift from individual to institutional investing is not the vital question. Personal involvement in both cases is virtually non-existent. What is important, however, is the construction of a system that protects both types of owners from breaches of fiduciary duty. We must remember that individuals increasingly are investing in markets through institutions, such as mutual and pension funds. Thus, we cannot forget that these institutions, although appearing monolithic, are nothing more than a collection of individuals.

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[8] A copy of resolutions to this effect proposed for adoption by several companies at their 1990 Annual Meetings is included as Attachment A.

4. In his testimony, Mr. Kirby stated, "many professional business managers and institutional investors have done a better job of looking out for their own interests than they have of living up to their responsibilities to society as a whole." As fiduciaries for pension fund beneficiaries, fund trustees are faced with the dilemma of choosing the short term gains offered in corporate takeovers, or waiting for the long term value of a company to be realized, perhaps for the greater benefit of all shareholders. How, if at all, would you propose enabling shareholders to choose measures for the "greater good" as opposed to serving their immediate individual interests?

It is essential to be precise on the exact meaning of the phrase "enabling shareholders to choose measures for the 'greater good' as opposed to serving their immediate individual interests." Defining what constitutes the "greater good" and "immediate individual interests," and, beyond this, when to take one over the other, is a dicey proposition at best. There are two possibilities, provided by David Engel and Michael Jensen, respectively:

(i) "The fundamental question of corporate social responsibility is when, if ever, it is socially desirable that a corporation organized for profit forego profit because some decision-making body or process within the corporation purports to identify a social need that pursuit of the profit motive will not fill."[9]

(ii) Is the "greater good" to be understood as a spaciously interpreted subcategory of profit maximization? "Even the most voracious maximizer of stockholder wealth must care about the other constituencies of the corporation. Value maximizing implies the corporation should expend resources (to the point where marginal costs equal marginal benefits) in the service of customers, employees, communities, and other parties who affect firm value by influencing the terms on which they contract with the organization or through the threat of restrictive regulation or decline in reputation." If this is the meaning of "stakeholder theory," there is no conflict with value maximization as the corporate objective."[10]

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[9] 32 Stanford Law Review 1, 12.

As David Engel points out, there are few situations in which deliberately non-profit-maximizing behavior over the long-term can be justified. The more difficult question is how to enable fiduciaries to forgo the clear incentive to sell in the present, opting instead to run the risk of loss in holding a security for the long term.

The posture of even the most tenacious fiduciary is difficult. First, he only retains business to the extent that he performs. Indeed, the "plan sponsor" who hires him may have a problem proving that the engagement was "prudent" in the absence of some kind of evidence of performance. How can such a fiduciary, holding a stock at market of $40, ignore a tender offer at $55? Even if he feels the achievable value within three years is $70, he knows that the acquirer can restructure and make even more. The institutional investor needs either legal or regulatory relief from this conundrum.

An effective way to deal with this problem is to distinguish between the objectives of various classes of institutional investors: their needs for liquidity and the appropriateness of taking the long view. Most investors need access to their capital; the principal exception to this is the defined benefit plan component of the public and private pension system. By recognizing that the pension systems are permanent investors, a controlling block of between 25 to 33% of the ownership of all large corporations (the percentage is larger with the largest companies) can stand apart from the destructive market place dynamics.

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[10] Jensen, Michael C., Articles Investors, LBOs,and the Privatization of Bankruptcy, before the House Ways and Means Committee, February 1, 1989.

In order to accomplish this desirable result, there is no need for expenditure of public funds, nor is there any need to impose costs on the pension system (the index investment of equity funds does not result in worse performance than active management). There is only a need to recognize the plain truth that funding the future pension obligations of working Americans can be effected through long-term ownership of corporate America available through a variety of indexes. Once the pension funds are taken out of the "Wall Street crap game," takeovers become less of a threat, perhaps more analogous to the situation prevailing in Germany, Japan, and Britain.

Pension funds have become a convenient scapegoat for market volatility. At this juncture, criticism of the index system is precisely the wrong attitude. Indexing, especially when done through a variety of indexes, stabilizes the market.

5. In a recent article, Harvard Professor Jay Light observed that the evolving system of equity ownership dominated by private positions in the U.S. is beginning to resemble ownership systems in Germany and Japan. Mr. Monks in his testimony stated that, while like Japan, Germany and Great Britain, we have a large portion of our capital in the hands of institutional investors, U.S. institutional ownership groups are not in synchronization with national economic and policy priorities, as is evident in Western Europe and Japan. How do you see the system of equity ownership evolving? Should

U.S. institutional owners have goals consistent with national economic and policy priorities?

It is estimated that there are some eighty million Americans who have an economic interest in the private pension system. ERISA trustees -- bound by law to consider only and exclusively the interest of participants and beneficiaries -- have to think of the long term and of the welfare of society as a whole. Pensioners have on average eighteen years of service before retirement. They want to be able to spend "real" pensions in a clean, well policed, orderly country. Can the interests of eighty million persons involved in the pension system as interpreted by trustees be taken as a proxy for the interest of society as a whole? An affirmative answer evokes the fabled "invisible hand" of Adam Smith.

If -- and I have no definite answer -- we conclude that the connection between shareholder and society is in need of more structure, then the concept I described earlier, the authorization of collective action groups for owners, serving as self regulatory organizations under the 1934 Act, might provide the appropriate element of public involvement.

6. A recent report issued by the New York State Task Force on Pension Fund Investment recommends that a pension investment unit be created to identify, screen and diversify the geographic and credit risk of investments aimed toward economic development. The report also recommends that additional guarantees for pension funds trying to carry out new economic development-oriented investment policies be provided. A recent Wall Street Journal article reported that the treasurers of 10 states

are "pledging to invest public pension money to spur each other's local economies and defend hometown companies against hostile takeovers." Mr. Monks and other experts have said they are troubled by the idea of using public or private pension assets for goals unrelated to the traditional standards of risk and returns. Please comment further on these suggestions.

F. A. Hayek had a profound insight into this very conundrum: "So long as the management has the one overriding duty of administering the resources under its control as trustees for the shareholders and for their benefit, its hands are tied; and it will have no arbitrary power to benefit this or that particular interest. But once the management of a big enterprise is regarded as not only entitled but even obliged to consider in its decisions whatever is regarded as the public or social interest or to support good causes and generally to act for the public benefit, it gains indeed an uncontrollable power -- a power which could not long be left in the hands of private managers but would inevitably be made the subject of increasing public control."[11]

My concern is not the suggestion that investments be made in jails and other infrastructure projects. The important question is: What are the terms of the investment? There is a market price of capital for public improvements, depending on the credit, the terms, and so forth. By suggesting that government guarantees be available for infrastructure investments, The New York State Task Force on Pension Fund Investment is saying either

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[11] Hayek, F.A. The Political Order of a Free People, (University of Chicago, 1979), at p. 82.

(i) without the guarantee, the other terms would not justify the investment, or
(ii) even with the guarantee, the investment would be at less than market rates with no ultimate risk of loss.

The first proposition is true (though not admitted by the Task Force) but the second logically false. If there is no risk, why a guarantee? A guarantee has traditionally served as a safety net for a dubious or chancy venture.

If the proposal is for a market rate investment, it is unclear why the pension system should be involved. On the other hand, an investment at less than market rates is a classic "social investment," defined by the deliberate foregoing of economic value in order to serve other objectives. Whether this is justified is another question altogether.

The underlying question is whether the tax incentives and the "exclusive benefit" standard that have traditionally defined the private system are still necessary. The tax question can be squarely addressed, taking into consideration the size of budget deficits, the needs for defense spending and other claims on the federal bounty, etc. Furthermore, the question of whether the "retirement income sector" can still claim full exemption from taxation must be answered.

Stated another way, we must wonder if the progress in expanding the coverage of the work force and funding past service obligations via pension funds has rendered the system of providing incentives through tax subsidy obsolete. The "exclusive benefit rule" raises the same question. In order to assure that needed "retirement income" deficiencies were addressed, it has been thought necessary to strictly limit the scope of managerial discretion. Again, the question is raised: Has the level of progress achieved to date justified broadening of the scope?

We must always remember that the money reserved for retirees belongs exclusively to the beneficiaries. It is only in the public domain to the extent that it is managed poorly, requiring additional tax dollars to make up the difference. Broadening the range of constituent groups whose concerns must be considered may sound appealing, but accountability to everyone is accountability to no one. In the end, the accountability provided by a strict fiduciary standard for both pension fiduciaries and corporate managers is not just the best guarantee of pension fund security, but of a competitive corporations and a strong economy.

7. In a recent article, Professor Michael Jensen of Harvard suggested that for certain industries the traditional corporate form, with centralized management and dispersed ownership, is outmoded and inefficient. Further, he suggested the model corporate form may be represented by the recent incidences of leveraged buyouts, i.e. -- managers of the company should also have a principal ownership stake. What are your views? If you agree, please comment on why many companies "go public" a short time after an LBO.

LBOs are by their very nature a transitional form of investment. LBOs represent an ideal, but brief, period in the life of a corporation when the involvement of full ownership is achieved. By their very nature, however, the components of this idealized state will change. The entrepreneurs will devote their attention to other businesses, the new managers will not be owners, the entrepreneurs will take their money out for consumption, and the heirs will have utterly different perspectives and competencies.

Thus, an LBO in its moment of conception achieves the commercial ideal of eliminating "agency costs" (economists' language for the friction of competing interests between managements and ownership). I am troubled by the indication that shareholders do not get a fair deal in an LBO, especially an MBO. But the fact that private ownership may provide special advantages at some stage of a corporations history and not others is not a concern to me.

9. If more and more institutions use indexing, and only established companies are part of the market indexes, what will be the implications for small companies seeking to raise equity capital through the public markets?

For background, Section 8438 (b)(1) of the Federal Employees' Retirement System Act of 1986 ("FERSA") requires the Thrift Investment Board to establish a Common Stock Index Fund. Sections 8438(b)(2)(A) and (B) provide further that:

"2(A) The Board shall select an index which is a commonly recognized index comprised of common stock the aggregate market value of which is a reasonably complete representation of the United States equity markets.

"(B) The Common Stock Index Investment Fund shall be invested in a portfolio designed to replicate the performance of the index selected under subparagraph (A).

The portfolio shall be designed such that, to the extent practicable, the percentage of the Common Stock Index Investment Fund that is invested in each stock is the same as the percentage determined by dividing the aggregate market of all shares of that stock by the aggregate market value of all shares of all stocks included in such index."

There appear to be four indexes which meet the basic statutory requirements: the S&P 500, the Russell 1000, the Russell 3000 and the Wilshire 5000, which represent respectively 66%, 79%, 86.9% and 94% of the total U.S. equity markets. Thus, there is a choice among indexes which permit varying levels of ownership of the total equity markets of the United States.

Ideally, broader market representation are preferred. It would be better to cover more of the market and diversify across a greater sample of corporate America. The smallest Russell 1000 company has a capitalization of about $250 million, while the Russell 3000 includes medium sized companies down to a capitalization level of $20-25 million. The question to be answered is whether smaller companies would be considered suitable for a typical institutional investor. More specifically, where would the line be drawn between sound investing in small companies and unsound investing?

In brief, existing indexes permit investment across the spectrum of American companies. The lower limit is the point where a company is so small it becomes unlikely that the investment would be considered "prudent".

11. Mr. Feldman testified that, with the large amounts invested in the market, many institutional investors simply do not have the time to examine companies on an individual basis. Thus, institutional investors have turned to greater use of indexing. At the same time, however, they argue for greater access to the corporate proxy. Is there a contradiction here?

No. The simple fact remains that voting can have quantifiable economic consequences. Therefore, a pension manager whose statutory obligations is to act for the "exclusive benefit" of plan participants must evaluate the voting choices with as much "care, skill, prudence, and diligence" as he does his trading choices. Index fund managers have an obligation to analyze proxy issues that is even greater than that for managers of other funds. Indexed funds provide no discretion for asset managers in trading; their only chance to protect and enhance the value of portfolio securities (and to outperform other indexers) is through the exercise of ownership rights.

Effective use of the proxy process by all institutional owners is essential to assure the integrity of the market as a whole. The accountability of managers to owners is an important element in achieving a maximum market value for a company. Under the current circumstances under which the largest plans are invested in "the market," action to assure the integrity of the components of the market is essential.

12. Many corporate managers have said institutional investors do not appropriately value the long term earning potential of their capital investments. In your view, how can corporate management more effectively communicate that value and, in turn, see that value more accurately reflected in a company's stock price?

Management must align their own economic interest as closely as possible with the interests of the company. Close alignment is the most important single step corporate managers can take to ensure market recognition of the full value of their company. This means compensation schemes must enrich managers only as shareholders benefit as well. All maneuvers that tend to insulate managers from the fate of the company -- golden parachutes, fixed dollar compensation agreements -- will tend to lower its market value. Shareholders do not object to company managers becoming rich so long as it is a reflection of gains to owners.

13. In your view, what accounts for the difference in share prices and the "control premium?" Some economists in the past have said the control premium reflects the market's expectation of the value of a company under new management. More recently, it might be suggested that the control premium reflects the difference in value of a company as a going concern, versus a company's break-up value. What is your view?

"Control" of a corporation is worth only the value of the rights it confers. There are six specific rights:

(i) The right to allocate resources in particular lines of business;
(ii) The right to determine appropriate risk levels (debt equity ratios, sale and lease backs of fixed assets, dividend policies, etc.);
(iii) The right to control the equity capitalization of the company through forcing minority shareholders to accept alternatives or judicially determined value;
(iv) The right to place business with lawyers, accountants, investment and commercial bankers, all of whom have a keen sense of reciprocity;
(v) The right to award appropriate perquisites to itself;
(vi) The right to determine whether any of the components of the company are to be sold, as well as to whom and for how much.

How much value a manager or an insider places on these rights is quite arbitrary. Only in a battle for control will the true value be determined.

14. Mr. Monks, in his testimony, referred to the race to the bottom in state laws affecting corporate governance. Do you believe there should be explicit federal minimum standards with respect to shareholder voting rights and other shareholder rights issues?

The California Senate Commission on Corporate Governance, Shareholder Rights and Securities Transactions, having considered its position as the world's sixth largest economy, concluded in March 1988: "California has three alternatives; (1) do nothing and continue to abrogate authority over large corporations with substantial business contacts, (2) pass a takeover law which applies only to a relatively few corporations, or (3) assert jurisdiction through federal preemption of state laws by virtue of its Congressional representation."

Pennsylvania has recently, in quite literal terms, given Delaware a run for the money with the passage of its recent anti-takeover laws. The Pennsylvania Senate has just passed SB 1310, which would continue the "race to the bottom" by entrenching management even further.

As California noted, the best alternative is some federal preemption of state laws, to set a floor for shareholder protections and a ceiling for management prerogatives in the governance of corporations. States would be free to set additional standards above the floor and below the ceiling. With a minimum federal standard, even set at the approximate base level of the existing Delaware law (which we do not advocate)[12], states would be free to decide an appropriate standard for the governance of corporations with the confidence that Delaware or some other state would not continue the downward spiral of shareholder rights.

There is nothing innately wrong with states having different standards for corporate behavior. What is divisive is the competition to lower standards in the "race to the bottom." Minimal federal preemptive standards would establish a fixed finish line for a previously bottomless race.

In addition, the significance of multi-state claims and disputes over the choice of law would be minimized as the disparities in state laws limited. This position is akin to the states' rights claim which was a major point of contention in CTS v. Dynamics. Yet opponents are missing the point that such a proposal actually would promote states' rights. Differences in governance standards should reflect regional differences, not state entrepreneuralism. To restate the earlier question: Would California be better served being preempted by the U.S. Congress or by the Delaware legislature? The current system in which a post office drop determines political and corporate behavior is totally irrational. It is an unimaginable metaphor for democracy.

15. A study prepared for the Subcommittee by Dr. Carolyn Brancato showed dramatic

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[12] The Bill of Rights adopted by the Council of Institutional Investors represents a more respectable starting point in the quest for suitable minimum federal standards.

differences in the portfolio turnover rates for various institutional investors. Some funds had turnover rates of over 300%; others had turnover rates of less than 10%. The study showed that bank trust departments had the lowest average turnover; mutual funds and investment advisers had the highest. What does this tell us about the "short term" versus "long term" argument, and what do you believe accounts for such a wide disparity in turnover rates? Do you believe we need more information in this area? What kinds of questions should be asked?

The low turnover rate for bank trust departments reflects the fact that a preponderance of bank trust assets are held in taxable accounts. Thus, sales will tend to cause the realization of taxable gain and thus incurring of greater tax. These tax payments will forever reduce the asset level of the account which is the basis not only for performance valuation but also for calculation of management fees.

Open end mutual funds, on the other hand, are registered under the Investment Company Act of 1940 and promise owners to redeem their shares at all times at the "net asset value" of the fund's portfolio. While, as a practical matter, it seems unlikely that at any given time a substantial portion of any fund's owners will want to redeem their shares, the managers need be sensitive to this possibility. Thus, they always have to be ready to meet massive redemptions. The nature of mutual funds is an advertised risk/reward investment in a highly competitive environment. No investor considers that he is buying the stock of a particular company; he is investing in a manager's ability to achieve particular income and capital growth results. Whether the advertised results have been achieved or not is susceptible to daily verification. Furthermore, switching between the several funds belonging to a particular group (Fidelity, Capital, IDS, Keystone, etc.) is often permitted without charge. This obviously exacerbates the need for fund liquidity and the tendency to high turnover rates.

Each class of institutional investor, foundations, universities, insurance companies have particular characteristics that account for differing needs for liquidity and turnover. Defined benefit pension plans have determinable needs for payment to beneficiaries that permit a high level of permanent investment. Indeed, unless it can be demonstrated that superior investment performance can thereby be achieved, pension plans have no need for liquidity (beyond the cash necessary to meet payments to retirees).

Recent analysis of private pension plans suggests: "Trading in the stock portion of pension portfolios, however, had a significant negative impact on net performance. The results suggest that, for the average plan, stock trading practices observed in 1983 lowered rates of return by 60 basis points relative to a plan that engaged in no stock trading. Pension plan stock trading would appear to be inefficient in the sense that superior performance (gross of expenses) in active portfolios is not high enough to offset research costs incurred to achieve higher returns."[13] On the other hand, Ippolito's study concludes: "..the negative effect of stock turnover does not appear to be present in the mutual fund data. Based on the available data, it appear that only pension plans suffer from 'too much' turnover in stock accounts..."[14].

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[13] Ippolito, Richard A., and Turner, John A., Turnover, Fees and Pension Plan Performance, Financial Analysts Journal, November-December 1987, 16.

So we can only echo his ultimate recommendation: "The results we have uncovered suggest that pension plan performance and investment practices are fertile ground for future research." It should be remembered that we have never seen a study that positively correlates investment performance with the level of portfolio turnover. This might be a useful subject for the Task Force recommended above to study.

16. A survey released by the Labor Department on March 4, 1989 reported that 39% of the investment managers interviewed said they had no responsibility for voting the proxies of the shares that they managed and that they did not know who did. Should this be a cause for concern?

The Department of Labor made clear in its Avon letter of February 23, 1988 that responsibilities appertaining to the ownership of portfolio securities -- including, conspicuously, the voting responsibility -- are "plan assets" according to ERISA. This means that discharging ownership responsibilities requires the same care, expertise and loyalty as required in the more traditional areas of asset management, such as buying, holding or selling securities. Recalling that nearly 40% of the outstanding ERISA equity holdings "fall between the cracks" of various fiduciaries exercising their prudent management, one can see the fundamental breakdown in either communication or enforcement or both.

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[14] Ibid. p. 24.

It is understandable that the Avon letter, released only twelve months ago, might need more time to communicate universally the emphasis the Labor Department places on the exercise of ownership rights by fiduciaries. However, at some point in the not too distant future, the DOL will have to take further steps if the message has not been received. At its disposal, the Department has Section 409 and 411, powerful weapons to deal with breaches of fiduciary responsibility. There is no need to prove consequential damages, which will always be a problem with negligence issues based on failures in the voting area. The DOL can suspend anyone from acting as a fiduciary for ERISA funds if they are found guilty of a breach of ERISA standards. This may impress many as a draconian remedy, but it may also be the only way that the DOL can communicate effectively.

When one contrasts the explicit leadership by DOL in this area with the benign neglect of the SEC over 1940 Act funds and the Bank regulatory agencies with respect to private trusts, one would be surprised if the voting record by those categories of institutional investor were not as bad, or even worse than with the ERISA equities.

There is no prospect of having effective governance without the involvement of shareholders. The effective communication and enforcement by the appropriate government agencies is an indispensable element in the process of overcoming the problems of "collective action." It is essential that government send an unmistakable signal of support for a shareholder-based governance system.

17. There have been suggestions that ERISA should be amended to permit fiduciaries a wider range of choice with respect to their investment decisions. What are your views?

According to Ira Millstein, "There is still a need to further clarify or modify ERISA and common law standards to harmonize traditional investment criteria with the emerging public policy regarding the use of private and public pension funds."[15] Millstein is concerned that "...the traditional investment criteria created by law were not designed to guide investment managers in making investments that may more indirectly benefit their participants: Basically, they were intended to impose a duty of strict loyalty and a technical interpretation of "prudence" on fiduciaries to ensure that fund assets were not misappropriated, diverted or used in a manner that did not directly further the interests of the participants. This view of the pension funds's obligation needs to be reconsidered."[16]

Before we consider broadening the standard of ERISA, we must remember why it was crafted so narrowly. The scrupulous commitment to pension beneficiaries was a response to abuses that left people who had worked and saved a lifetime without the funds that were rightfully theirs. The ERISA requirements for managing in the single-minded interest of plan beneficiaries are as plain as the English language is capable of specifying. It is generally accepted that government policies encouraging the funding of private pension promises are effective in furthering this vital national objective. Some people now believe that enough progress has been made so that, in light of the huge deficits and requirements for funding in other directions, it would be prudent to redefine the priority placed on encouraging retirement asset generation. If so, the question should be faced squarely.

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[15] Opening statement by Ira M. Millstein, Chairman of the New York State Pension Investment Task Force, before the House Committee on Education and Labor Subcommittee on Labor-Management Relations, 2/9/89 at page 15.

[16] Ibid., at p. 11,12.

It does not serve a useful purpose to intertwine questions on the need for public infrastructure investment via well-funded pension systems with an implicit promise that both social funding and retirement funds can be accommodated without cost. If government guarantees are going to be available (and they have a cost, as the Savings & Loan situation makes painfully clear), it is unclear why pension plans need be specifically involved in the investment process, unless despite the guarantees, it is proposed that the securities be issued at less than market value. As noted above, guarantees themselves have a cost, as demonstrated by the current Savings and Loan debacle. At this point, it seems to us essential that the merits of decreasing the emphasis on pension asset generation and increasing the emphasis on other societally valuable purposes should be carefully addressed. The notion that something of value can be produced without cost is pernicious.

18. In view of the changes in the market and in corporate governance resulting from increased institutional participation, what, if any, specific changes would you propose to the Federal securities laws? To ERISA?

What follows is merely a "wish list" for Congressional action with respect to securities law and ERISA amendments:

(i) We must have a federal law of corporations that does not pre-empt state law but does set some kind of baseline. Perhaps a kind of "bill of rights" -- the document prepared by the Council of Institutional Investors styled as a "bill of rights" is a useful starting point -- providing some assurance that minimum rights of ownership cannot be abrogated by state law. Federal legislation should establish minimum standards to protect the integrity and efficiency of shareholder voting. Possible actions could include:

-- requiring formal audits for the voting process (not just to count ballots, but to make sure that all of them are sent to and voted by the right people);
-- establishing a "level playing field" for shareholder resolutions and nomination of directors (i.e. equal access to the ballot);
-- requiring shareholder approval of poison pills and compensation schemes (currently, shareholders' only right with regard to executive and director compensation is to approve stock options);
-- protecting the "one share one vote" mandate
-- eliminating coercion found in the current takeover market by requiring an independent evaluation of a tender offer and the opportunity for shareholders to weigh competing tender offers, coupled with the "English rule" permitting shareholders to vote against a tender offer while retaining the right to put their shares to a successful tenderer at the offer price.

(ii) Providing confidential voting before the meeting and disclosure by fiduciaries to their beneficiaries after the meeting would make coercion more difficult.

(iii) The ERISA standards for fiduciary responsibility should be extended across the federal and public pension systems.

(iv) Careful consideration should be given to the question of proscribing or encouraging the indexing of equity holdings by ERISA plans.

19. Although the hearing focused primarily on corporate governance issues, recent stock market activity has rekindled questions raised in October, 1987 about the impact

of institutional investors on market volatility. What are your general views on this issue? The hearing focused on the responsibilities of institutions with respect to corporate governance. Do institutions have new responsibilities with respect to their trading activities?

It is virtually meaningless to talk about institutional responsibilities in the abstract. The problems of collective action and fiduciary responsibility sharply circumscribe the range of action that even the most well-intentioned and conscientious institutional investor can prudently undertake. Consider the problem of an institutional investor holding hundreds of millions of dollars of investment, amounting to 1% of the ownership of a giant malefactor. How can this fiduciary possibly justify the enormous expenditure of its beneficiaries' funds to investigate and remedy the malefactions when the end results of such an effort, after expenses, will ultimately net them a lower return? There is precious little scope for action by fiduciaries.

The only way in which the fiduciary and collective action problems can be addressed is via standards set by appropriate government agencies. No fiduciary can be accused of being Quixotic or wasteful in incurring expenditures to comply with standards required by relevant regulatory agencies.

We have expressed elsewhere in our formal testimony -- in testimony earlier this year before the House Labor Committee and in answering these questions -- our belief that several valid public policy objectives would be served by encouraging a standard of indexing for ERISA equity holdings. The impact on trading activity is self evident:

between 18% and 25%[17] of the market would be liberated from short term activity.

The potential impact on governance is equally dramatic, as a solid base of the total equity of Corporate America would be in the hands of permanent-holder fiduciaries. Furthermore, there would be no cost to pensioners in terms of decreased investment performance of the plan assets. Former SEC Chairman David Ruder pointed out the correlation between these two problems: "We are going to have permanent passive investment by institutions... I look at institutional ownership, banded together, as beginning to provide an ownership to which management is responsible again... Q: So with regard to the big companies they can't not own, they have to get into the board room? A: That's what I see as likely to occur."[18]

20. Institutional investors have been criticized for having a short-term investment horizon. Is this a valid criticism with respect to any class of institutional investor? If so, what specific steps would you suggest to encourage longer-term holding of equity securities?

The answer to question #19 deals with many of these issues. In our view, mutual funds are apt to be short term investors due to the nature of the product they are offering. A mutual fund holder has the right to redeem his holding at any time.

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[17] This figure would depend on whether the impact of the policy would extend to "public" funds.

[18] Barron's 10/16/89 (dated after, but spoken prior to, the recent Crash of October 1989)

Thus, the manager must be in the position to liquidate any or all of his holdings on twenty-four hours notice. Also, mutual funds are highly competitive -- the "score" is daily available -- and there is great movement between funds. All of these factors make clear that mutual funds, per force, are short term and have a high need for liquidity.

Other institutional investors, like insurance companies and personal trusts, seem to be more in the category of pension plans. There seems no "performance related" reason why they should be short term.

To quote Sir John Hicks: "It may therefore be observed, in conclusion, that there is something to be said for the system, which seems to be evolving under the pressure of taxation, in which the shares of large companies are held, in large blocks, by institutions - banks, pension funds and so on - which have a sufficient stake in the company to have an incentive to keep in close touch with its affairs, just as the holder of a non-transferable share has an incentive to do. Such a system could indeed be regarded as that of the private company writ large. It would indeed lose something, perhaps much, in flexibility; but it could offer gains in other ways."[19]

21. Does a trustee's or investment managers' obligation to act in the beneficiaries' best

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[19] Hicks, Sir John, Limited Liability: the Pros and Cons, at p. 20 of Limited Liability and the Corporation (ed.Tony Orhnial) [Action Society Trust, 1982].

interest require that funds be actively managed? If so, why? Is there any empirical evidence showing that for larger funds, in the aggregate, active management yields above-market returns? Is passive management or indexing contrary to fiduciary responsibilities?

Recent studies have made clear that active management of pension assets has not resulted in increased values for the participants and beneficiaries.[20] Wilshire Associates "surveyed our data base of 222 live accounts over 7.5 years representing $40 billion in equities as of June 30, 1986. The performance of each stockholding in every portfolio has been calculated by Wilshire, representing 1,700 quarterly observations and a half million separate performance calculations" with the following results: "the net management effect is zero."[21]

Equity Managers'

Box Score

How Managers Add (subtract) Value

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[20] Richard A. Ippolito, Pensions, Economics and Public Policy. Homewood, IL: Dow Jones-Irwin, 1986 [Ippolito 1986]; Richard A. Ippolito and John A. Turner, "Turnover, Fees and Pension Plan Performance," Financial Analysts Journal, November-December 1987 [Ippolito 1987] {"A CAPM-based analysis of the data reveals that, net of investment fees and turnover expenses, private pension plans underperform the S&P 500 by approximately 44 basis points per year..."}; Stephen A. Berkowitz, Louis D. Finney and Dennis E. Logue, The Investment Performance of Corporate Pension Plans, Quorum, 1988 [Berkowitz 1988].

[21] The Equity Manager Box Score, (Wilshire Associates, 1987), p.3 (emphasis added).

Management Activity	Incremental Performance
Market Timing	(0.8%)
Sector Weighting	0.7%
Stock Selection	0.6%
Trading	(0.5%)
Net Management Effect	0.0%"

Highly-respected Charles Ellis of Greenwich Associates recently wrote: "Investment management as traditionally practiced, is based on a single basic belief: Professional investment managers can beat the market. That premise appears to be false, particularly for the very large institutions that manage most of the assets of most trusts, pension funds, and endowments... The stark reality is that most money managers have been losing the money game. The historical record is that in the 15 years ending with 1984, on a cumulative basis, nearly three quarters of professionally managed funds underperformed the S&P 500 stock market average."[22]

One must come to grips with the stark reality that despite the billions of dollars in fees paid to money managers, consultants, and all manner of professional service providers, the economic consequences for the benefactors -- the pension plan participants -- have been no better than if all the equity funds had been invested in market indexes.[23] Logue has, however, pointed out certain other consequences emanating from management of pension funds: "From May 1975, when fixed minimum commissions on equity trades were eliminated, to 1983, commission charges on equity trades declined by two thirds; simultaneously, equity portfolio turnover roughly tripled for ERISA plans, endowment plans and public pension plans..."[24]

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[22] Charles D. Ellis, Investment Policy. Homewood, IL: Dow Jones-Irwin, 1985, pp. 4 and 9.

Increased turnover has several deleterious effects. There has been criticism of the potential and actual impact of institutional involvement in the October 19, 1987 market collapse, none as appropriate as the angry judgment of Louis Lowenstein: "These high turnovers are destructive of all the goals and functions we have set for investors in the management of their own and their clients' money, in the operation of the market, and in the governance of corporations. They impose an exorbitant tax on the funds that are being churned, currently reducing by about one-sixth the underlying stream of income. By encouraging an emphasis on trading rather than investing, they focus the intelligence and energies of the investment community on short-term developments. By disguising the fact that there is liquidity for individuals but not for the community, they divert attention from the business fundamentals that are the market's proper concern. They turn shareholders into traders and investors into gypsies, who could not sensibly have more than a trivial interest in how to vote their shares or otherwise act as guardian of the corporate store."[25]

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[23] Just how large this sum is may be approximated from Wilshire's work. "Brokerage commissions and even the impact of trades is small in comparison to the amount of fees paid to managers. Wilshire's clients tend to have large funds so the fee component for equity management is only about 0.4%". Total pension funds approximate $2 trillion, so fees might approach $8 billion per year.

[24] Logue, p.3.

The question government ultimately must ask itself is: "In aid of whom?" In aid of what body of constituents and for what public policy do we maintain this "subsidized sandbox?" The public markets and the governance of corporations suffer, and the beneficiaries do not gain. Why should a system with those characteristics be allowed to continue? Even more to the point, why is this system being subsidized at the rate of $55 billion per year?[26]

To focus on one present facet of the tax-free-investor world, what positive result can be expected from an increasingly short-term trading orientation? It is all very well to pontificate about the virtues of free and untrammelled markets, but it is better to ask whether the functioning of the market is the unique indicator of societal benefit.

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[25] Lowenstein, Louis, What's Wrong with Wall Street, Short Term Gain and the Absentee Shareholder, (Addison-Wesley, 1988) at p 65.

[26] This is the estimated annual "tax cost" of the current system of providing incentives for retirement income.

The nature of pension funds is significantly different from that of other institutional investors; defined benefit plans (which are the preponderance of both public and private systems) promise finite payments to known plan participants at certain times in the future. Actuaries can and do calculate the precise liquidity needs of such plans; the cash needs could well be met by investing a portion of plan assets in debt securities with appropriate maturities while pursuing a genuine long term investment policy with the preponderance of the assets. Pension fund beneficiaries on average have eighteen more years of service before retirement, they have an interest not only in being able to pay their bills, but also in living in a clean, peaceful, law abiding country at the time of their retirement. They have a long-term interest in the capacity of companies in which they invest to be productive, to be innovative, to be able to add in value. Thus, from the point of view of the ERISA beneficiaries, there would be no loss and there could be substantial gain from the adoption of a new policy that would limit the extent of short term investment permitted in equity portion of their holdings.[27]

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[27] Would it do violence to the public interest to require that all equity investments under ERISA be invested in index funds? One way to achieve this result would be to have the Secretary of Labor decree that an index constitutes "safe harbor" for ERISA prudence. This would leave managers free to invest in any manner they deemed appropriate, but would leave them with the burden of proof that investment results that did not achieve the levels of the index were prudent. Indexing up to 20% of the equity markets would reduce short term trading and would provide a base of "permanent ownership" with a long term optic for American business. If the index used were the Wilshire 5000, for example, pension plan capital would be available to all publicly traded companies. Robert A.G. Monks' Testimony before the House

Furthermore, there are no legal obstacles to such a policy. The Department of Labor has expressly opined that "index investing" is not contrary to the "prudence" requirement under ERISA.[28]

22. [A] How does corporate activism on the part of institutional investment managers contribute to higher fund performance?

Shareholder activism can produce positive investment results in at least two ways. First, holding management accountable to shareholders can cause the market to value the company higher. Jonathan Charkham, Adviser to the Governors, Banks of England, pinpoints the way in which the present day institutional investor can--and should--require that his concerns are reflected in the management of corporations.

> This means that if VOICE is to be used it must be the institutional shareholders who are going to use it... Our institutions' self-interest in voicing rather than exiting rests increasingly on the fact that it is difficult to dump big holdings without moving the market; and to a lesser extent on the perception that it can be very profitable to buy into a company and cause its management to be stirred up to produce a better performance which will eventually be reflected in higher dividends and share price. There is probably great scope for more of such action to be undertaken, collectively by the institutions, where necessary, and it would be good for them, for the companies and for UK, (and probably for the

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[28] See 44 Federal Register Vol. 124, June 26, 1979 at p. 37, 224.

United States too), and well worth the minor expense it might require."[29]

A specific example of the worth of such action, as well as the positive long-term effects it brought, was the collective action this year by institutions in opposing two governance proposals by the management of Honeywell. The market's favorable response directly tracked the announcement of the opposition by the institutions--and its success.

The second way that activism can add value is by preserving the independence of well-run companies in the face of an insufficient tender offer. Robert G. Kirby, CEO Capital Group, in a speech to The Business Council earlier this year, stated:

> What point is there in trying to seek and to heed the advice and counsel of shareholders who will not be shareholders two or three quarters from now? ... Share ownership doesn't seem to carry any responsibility. Corporate democracy has never really existed in the U.S. or, as far as I know, anywhere else... However, given all the aforementioned shortcomings of institutional investors and their extremely opportunistic approach to investment decision making, I still believe that corporate managements are losing a constructive opportunity in not trying to work more closely with their major shareholders... [E]very good company has a core of real investors who are looking at the long term. In many cases a company could call fewer than ten institutional shareholders and be talking to perhaps 20-30% percent of its ownership. It seems to me a defense worked out with the cooperation of these institutional shareholders would be easier, a whole lot cheaper, and more certain of success than would a defense worked out in smoke-filled hotel rooms with

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[29] Jonathan Charkham, Corporate Governance and the market for control of companies, Panel Paper #25, March 1989 at p. 8.

a batch of investment bankers and lawyers."[30]

22. [B] If an investment manager felt that a company and its management was underperforming, would the fiduciary obligation to maximize value mandate that the shares be sold?

Selling the shares of an underperforming company is not an action to maximize value, but to minimize loss. Fiduciary obligation would mandate some action when a company is underperforming. Institutional shareholders can take cost-efffective action to enhance value--as they did in Honeywell--and that is more consistent with fiduciary obligation than selling the shares.

Selling out of an underperforming company is simply acquiescing to poor management and to assured loss for beneficial owners. As Edward Jay Epstein points out, "just the exchange of one powerless shareholder for another in a corporation, while it may lessen the market price of shares, will not dislodge management--or even threaten it. On the contrary, if dissident shareholders leave, it may even bring about the further entrenchment of management--especially if management can pass new by-laws in the interim.[31] The only conduct suitable to achieve appropriate values for the long term holders is one of effective shareholder activism.

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[30] Robert G. Kirby, in a speech to The Business Council, 5/13/89. Attachment B is a recent letter that we sent expressing a similar opinion.

[31] Edward Jay Epstein, Who Owns the Corporation 24-25.

Attachment A

STOCKHOLDER PROPOSAL

RESOLVED, that the Company shall have a Shareholder's Advisory Committee to advise the Board of Directors on the interests of shareholders. The Board of Directors shall ensure the formation and effective operation of this Committee and shall give due consideration to such advice and proposals as shall be reported by this Committee to the Board. Members of the Committee shall serve without costs to the Company, except that the Committee shall be reimbursed for normal travel and operating expenses. The Committee shall be composed of at least nine members and shall be reconstituted on an annual basis. The Board shall establish appropriate procedures for selection of members, provided that (i) each member is a beneficial owner of at least 1,000 shares of the Company's voting stock for the entire period of membership, (ii) no member has any affiliation with the Company other than as a shareholder, and (iii) at least five members are selected from the 50 largest beneficial owners of the Company's voting shares. No member may serve more than two consecutive terms.

SUPPORTING STATEMENT

As a $56 billion public pension fund with long-term investment objectives, we believe that the decisions of the Board of Directors should be made with due consideration of the views of shareholders. However, there is currently no organized forum through which shareholders can express those views. This proposal would establish an advisory committee and institutionalize a procedure for developing and communicating shareholder input. We believe that this structure will benefit the Company by assuring that the Board is aware of the perspective of shareholders as it makes its decisions.

The Shareholder Advisory Committee would have no authority to bind or to act on behalf of the Company. It would operate solely in an advisory capacity. Furthermore, this proposal will not restrict the ability of the Board of Directors to take whatever actions it deems best for the Company. The Committee structure merely creates a means to enable such actions to be taken with full consideration of the views of stockholders. By supporting our proposal, we believe shareholders will help ensure that our Directors are in a position to make decisions with a better understanding of the interests of shareholders.

Attachment B

INSTITUTIONAL
SHAREHOLDER
SERVICES, INC.

October 12, 1989

Mr. Robert L. Crandall
Chief Executive Officer
American Airlines
P.O. Box 619167
Dallas Fort Worth Airport
Texas 75261-9616

Dear Mr. Crandall,

The recent offer by Donald Trump elicited a unique response from several of our institutional shareholder clients. Let me give you the flavor of what Dale Hanson, the Chief Executive Officer of the Public Employees Retirement System of California ($50BB of assets), said to me: " I want this institution to back the management of a well run American company in the face of a tender offer providing opportunity for short term profits. I think that this situation with American is just the right one for us."

I then called a half dozen of the largest shareholders of American, several of whom we represent, and passed on to them Dale Hanson's thoughts and asked for their reaction. It was uniformly positive.

Now that the immediate threat has past, wouldn't it be sensible to "seize the minute" and capitalize on the reservoir of good will that you and American have with your largest shareholders. There are many possibilities and I would be glad of the chance to talk with you about them.

Respectfully Yours,

Robert A.G. Monks

Robert A.G. Monks
President

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OPENING STATEMENT BY
IRA M. MILLSTEIN*

BEFORE THE SENATE COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS
SUBCOMMITTEE ON SECURITIES
SENATE DIRKSEN OFFICE BUILDING
WASHINGTON D.C.

TUESDAY, OCTOBER 3, 1989
9:30 A.M.

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here today to testify before the Subcommittee.

As Congress embarks on serious consideration of the role of institutional investors, particularly public and private pension funds, in the capital markets and in corporate governance, I suggest that there are two central themes upon which to focus:

1) There is an objective to considering any party's role in corporate governance; corporate governance is not an end in itself. We are not dealing with abstract principles of justice and democracy as is sometimes the case in public governance. Rather, we are dealing with state

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* Ira M. Millstein is Chairman of the New York State Governor Cuomo's Task Force on Pension Fund Investment. He is also Chairman of the Board of Advisors of the Institutional Investor Project of Columbia University School of Law's Center For Law & Economic Studies and Senior Partner at the law firm of Weil, Gotshal & Manges.

chartered economic entities (corporations) competing in global markets. Today, public policy is searching for ways to encourage these economic entities to be more competitive in that marketplace, hence more efficient, more innovative, and more ready and willing to take the technological and organizational risks needed to compete successfully. Whatever Congress does in the arena of corporate governance should be directed at enabling corporations to undertake the tasks necessary to make them world-class competitors.

2) Corporate governance is comprised of at least three entities: Management, the Board of Directors, and Shareholders. Each serves a crucial but very different function. Management obviously manages the day-to-day affairs of the corporation, and devises and implements business strategies; neither the board nor shareholders can or should attempt this. The board selects top management, which is accountable to the board for its performance. The board must devise its own processes to review management's performance, and assess its business strategies. The board, in turn, is elected by the shareholders, who provide capital to the corporate enterprise and to whom the board is accountable for carrying out its oversight responsibilities.

Congress is now addressing its attention to the shareholder role in corporate governance. It is today -- and will be more so tomorrow -- a role increasingly played by institutional investors, and in particular pension funds. In considering this shareholder role, Congress must distinguish it from the management and board roles, which involve very distinct and different functions. Shareholders don't manage and they don't directly oversee the management; they elect directors who undertake to oversee management in their stead.

Shareholders who are dissatisfied with a corporation's performance have various remedies, including most importantly, selling their shares and forgetting about the governance of that corporation. Shareholder attitudes can therefore be critical, since through the purchase and sale of shares, shareholders determine the company's financial market value -- a value which today plays a large role in management's strategic planning. Yet, despite their importance, shareholders still only comprise a single entity of the governance system. Accordingly, their appropriate role should be distinct and clear.

To assess the role of institutional investors in corporate governance, Congress will want to comprehend the institutions' attitudes toward investing and trading in shares, and in particular their policies as owners of shares. More importantly, Congress will want to understand how such attitudes as investors, traders and owners of shares impact on the ability of corporations to risk and innovate and improve their performance as global competitors.

I am delighted that Congress is initiating these inquiries, for there is a significant need to formulate and articulate a public policy stance with regard to the role of institutional investors in corporate governance and the capital markets.

I recently chaired the New York State Task Force on Pension Fund Investment, which was appointed by Governor Cuomo as the first of its kind in the nation to study the impact of pension fund investments on our economy. In June, after seven months of intense collaborative effort to harmonize the diverse views of a broad group representing pension funds, unions, corporations, government and the public, the Task Force issued its report.[1]

That Report, entitled "Our Money's Worth," reflects a public policy consensus: that in a very real sense pension funds are our money; that taxpayers, the government, labor, and corporations (both as issuers of stock and as fund sponsors) have legitimate interests in how pension fund ownership and investment decisions are made. Of course, everyone's primary concern must be the financial integrity of the fund -- its ability to assure retirement benefits -- but public policy must also consider the consequences and impacts of the actions taken by funds in securing retirement benefits, just as public policy considers the consequences and impacts of the actions corporations take in seeking profits.

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[1] See Our Money's Worth: The Report of the Governor's Task Force Pension Fund Investment (June 1989).

The Task Force noted that pension funds -- because of their growing economic power -- have moved into the public policy limelight. Our Report pointed out that institutional investors, especially pension funds, have been assuming a dominant role in the capital markets over the past 15 years. Pension funds are not only a source for payment of retirement benefits for millions of retirees, but also are a primary source of capital in the United States, and an increasingly important influence on corporate management. By the year 2000, it is projected that institutional investors will hold over two-thirds of all shares in the large publicly-traded corporations.[2]

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[2] In 1988, all categories of institutional investors had assets under their management in excess of $5 trillion. Furthermore, they had increased their ownership in the top 50 U.S. corporations from 49 percent in 1987 to 52 percent in 1988. Holdings of public and private pension funds comprised approximately 44 percent of assets of all institutional investors; representing growth in excess of 14 percent per year from the $891 billion in assets held in 1981 to over $2.3 trillion in assets held in 1988. See Dr. Carolyn Kay Brancato, Institutional Investors and Corporate (continued...)

With power, however, must come responsibility. Coincident with the power they now wield, pension funds have a substantial impact on and, therefore, a responsibility for corporate America and ultimately the course of the American economy.[3] Pension funds do not operate in a vacuum; their investment and ownership decisions impact in direct proportion to their growing size.

Because pension funds have a direct impact on American corporations and our economy, numerous diverse groups -- which, for lack of a better term, I call "stakeholders" -- are beginning to express concern, and rightfully so, about how pension funds operate. The Task Force Report is evidence of that concern. "Stakeholders" are not limited to those with a cognizable or enforceable legal interest in

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2. (...continued)
America: Conflicts and Resolutions. An Overview of the Role of Institutional Investors in Capital Markets and Corporate Governance, Prepared at the Request of the Subcommittee on Securities, Committee on Banking, Housing and Urban Affairs, United States Senate (October 3, 1989).

[3] Regardless of how one interprets our trade balance situation -- or criticizes whoever is at fault -- all sides agree that to succeed competitively, American corporations must adopt a longer-term view. See Morita (Chairman, Sony Corporation), Something Basic is Wrong In America, The New York Times, October 1, 1989, Section 3 at 2; Hennessy Jr. (Chairman/CEO Allied Signal, Inc.), Japan's Market is Closed Drum Tight, The New York Times October 1, 1989, Section 3 at 2. (Copies of the Articles are annexed hereto as Appendix A and B).

the funds -- namely the beneficiaries. Rather, they include the wide range of individuals and organizations who are impacted by the investment and ownership decisions of pension funds. Stakeholders include current retirees and employees[4] -- the traditional and primary stakeholders, as the pension funds' beneficiaries -- corporations as sponsors of funds and as the entities in which the funds invest, government and taxpayers, as well as the general public.[5]

As sponsors of pension funds, employers generally take on the dual obligation of contributing the bulk of the assets that finance retirement benefits, and participating in the selection of the fiduciaries who invest those assets for the benefit of generations of workers. Therefore, the health of the funds is inextricably linked to the health of their sponsors (public and private). Moreover, as entities in which pension funds invest, corporations also have an interest because of the impact that pension funds have on their ability to take risks and innovate. As corporations face the threat of a takeover, or restructure themselves to enhance their competitiveness, pension funds become increasingly important as significant actors in the capital markets. Additionally, corporations themselves have many stakeholders -- including their shareholders, employees, suppliers, customers, and the communities in which they operate -- who are impacted by the investment and governance decisions of pension funds.

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[4] Current retirees and employees have a multiplicity of interests, including but not limited to the payment of retirement benefits. For example, a present employee who is a plan participant has an interest not only in his future retirement security but in his present job security, which requires a healthy employer and a healthy economy. His retirement security may well require a healthy plan sponsor.

[5] The general public has an interest in pension funds to the extent that these funds play an important role in ownership decisions and in the functioning of the capital markets, and hence on the functioning of the corporations in which they invest, thereby impacting on the health of our economy and our standard of living.

Not the least important, taxpayers and government have a substantial interest in how pension funds behave, since not only do they sponsor funds for public employees, but pension funds -- unlike most other investors -- receive tax favored treatment. Government and taxpayers promote these funds because of the vital public purpose they serve in providing retirement security. Indeed, the funds have proliferated and have been enabled to amass their substantial assets so quickly because of their favored status: Corporations are accorded tax deductions for contributing to pension funds; the funds themselves are tax-exempt; and employees are generally not obligated to pay income taxes on employer contributions made on their behalf throughout their working years, but are taxed only as benefits are received by them. Some state governments provide additional tax benefits to employees by excluding retirement benefits, particularly government pensions, from state income taxation.[6] Finally, the retirement benefits of ERISA pension funds are insured to a certain extent by a government-sponsored pension benefit insurance program. Due to their sponsorship of public employee funds and the significant tax benefits and incentives granted -- designed to encourage employers to establish and contribute to pension plans -- taxpayers and government both have a legitimate public policy interest in these funds.

Despite their enormous growth in asset size, corporate ownership and power in recent years, and their impact on a variety of stakeholders, pension funds continue to be governed by ERISA, the common law and a web of other laws and regulations created in an earlier era.[7] Perhaps at the time of their inception, it was reasonable and prudent for pension funds to focus exclusively on their own narrow financial performance. However, with the enormous impact of the funds' power on our economy, it is clear that pension funds must now take a broader view. Given that pension funds are the largest single investors in our equity markets and thus play a key role in the allocation of capital, as well as in corporate governance, it is fair -- and in the public interest -- to ask that these funds consider the full economic impact of their actions, and to act in a manner that will foster our country's economic prosperity.

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[6] See generally Appendix C.

[7] This web of constraints may be perceived to cause fund fiduciaries to invest or vote on ownership issues in a manner that emphasizes yield, risk aversion, and direct and immediate benefits over (and perhaps to the exclusion of) broader, long-term and more indirect benefits to plan participants. But, these traditional legal standards were not designed to guide investment managers in making complex ownership and investment decisions having broad impact on our economy and society. Rather, they were intended to ensure that assets be set aside and continue to be available to provide the benefits promised by pension plan sponsors. One of the principal concerns was to protect pension plan (continued...)

This obligation is consistent with the funds' legal duties to provide retirement assets. Without a strong economy, healthy sponsors, and healthy corporations, America's workers will not be assured their retirement security. Thus, government, taxpayers, corporations as

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7. (...continued) assets from malfeasance. The law's focus on the duty owed to plan participants provides little guidance regarding the extent to which the health of the other stakeholders may be factored into investment and ownership decisions, consistent with the role pension funds now play as important economic institutions. In my view, the current law does not foreclose a fiduciary from considering matters that have an economic impact upon participants and beneficiaries. This is a matter which obviously must concern Congress. If existing law from another era inhibits what may be determined to be current public policy, that law must be reexamined.

sponsors and as issuers of securities and, of course, preeminently, pension fund beneficiaries, all have a stake in pension fund investment and governance decisions.

What public policy and legislatures have created, public policy and legislatures can modify and change. Public policy is not static, it is dynamic. What was suitable policy for one era -- encouraging the establishment and growth of pension funds as separate and insular entities, without regard for broader issues of economic policy -- may not be sufficient for the next era, in which pension funds have amassed outcome-determining power in the financial markets and in corporate governance. If pension funds do not voluntarily consider broader investment and ownership strategies that take into account the impact of their actions on their multiple stakeholders, I have no doubt that legislatures will help them. Note the recent suggestion by Senator Kassebaum that a tax be imposed on pension funds' short-term profits as a means to encourage long-term ownership.[8]

In another context, recent legislation has signaled a recognition of the broad interests of various stakeholders in the actions of entities organized to produce goods and services -- the modern corporation. New York recently amended Section 717(b) of the New York Business Corporation Law to allow directors of corporations -- in determining what the long and short-term interests of the corporation and its shareholders are -- to consider the effects of the corporation's actions upon its current and retired employees, its customers, suppliers, and creditors. New York is not alone in taking legislative initiatives to consider the impact on non-traditional stakeholder groups. More than 20 states have done so. These initiatives indicate legislative recognition that traditional concepts governing fiduciary-like relationships are changing and broadening.

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[8] See Senator Kassebaum, How About Taxing Pension Fund Profits, The New York Times, August 30, 1989, at A23, col. 1.

The consensus I find developing in academia, the legislatures, and increasingly in business circles is that any institution whose very being is the result of governmental policy is obligated to consider, in its actions, its broader impact on our economy and society. It cannot blindly pursue a single objective -- be it profit for a corporation or employee retirement security for a pension fund -- without considering the consequences of its actions.

As the world evolves and, hence, public policy evolves, it is appropriate that pension funds -- which are creatures of public policy -- also evolve. The modern reality is that pension funds must responsibly exercise their enormous power. To act responsibly they must adopt a broader outlook -- and make their decisions with a view towards how their investment and governance decisions impact upon their stakeholders. I think these considerations are a part of, and consistent with, the traditional concern for the pension fund beneficiaries; in the long run, considering and harmonizing all stakeholder interests despite the complexity of the task, will benefit the pension fund beneficiaries.[9]

Just as legislatures may step in to assist pension funds in considering the broad impact of their decisions, sponsors of pension funds, corporations, and again, government -- may, and I believe, should -- assist the funds they sponsor to act responsibly.

With respect to private sector pension funds, the board of directors is uniquely positioned to harmonize the broader need of the private sector to plan and develop, in a manner that fosters innovation through risk taking, with the narrower concerns of its own pension funds, encouraging the growth of investment assets so as to assure retirement benefits. To this end, I urge that through their boards, corporate sponsors articulate responsible investment and governance policies for the funds they sponsor and, specifically, apply their knowledge of corporate governance to those policies.

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[9] I am not advocating social or suboptimal investing when I urge that pension funds consider the broad economic impact of their investment and ownership decisions. But I do agree with the Task Force Report that if government wants to encourage social investment, it can do so -- with guarantees or other programs to assure pension funds a sound return. After all, it is well within the legislative prerogative to decide, as a matter of public policy, that pension fund money, properly directed and guaranteed by government, may be used to a prudent degree through joint public/private initiatives to enhance the economic infrastructure -- bridges, roads, hospitals, schools, housing, etc. -- on which all economic prosperity ultimately depends.

Because of the ever increasing complexity of governance and investment decisions that pension funds face, they require expert guidance. However, the complex legal standards governing the funds' investment and governance decisions have led sponsors of pension funds to fear legal liability arising from their fiduciary status. This, when coupled with the protection granted by ERISA to a specific investment decision if made by an independent investment manager, has led some corporate boards to delegate entire control over their funds' investment and governance decisions.

Boards of directors should apply their expertise to the complex issues faced by funds as owners of shares; they should assume responsibility for over-all policy to guide investment and governance decisions. Pension policy should be recognized as an important element of corporate strategy and, while boards cannot assume the day-to-day duties of plan administrators and investment managers, they can set broad policy.

Boards should set policy for the pension funds they sponsor that encourage corporate managers to be prudent risk takers and innovators -- to add value over the long term. Corporations should take care to see that their own pension funds do not routinely do that to which they object from their own shareholders, i.e., pressuring (by investment and governance decisions) corporate managers to produce short-term returns at the expense of real economic growth over the long term.

I have articulated a rather broad public policy goal which would suggest that plan sponsors can and should take into account -- in considering the best interests of the beneficiaries (current and retired employees) -- the impact of their actions on other stakeholders: the sponsor, the investment targets, the government, the taxpayers, and the public. The task of harmonizing such concerns is a complicated one, although it is no more complex than the task of the modern corporate board which must harmonize its duty to profit for shareholders with the interests of the corporation's other stakeholders. Ultimately pension fund beneficiaries will reap the benefits of the efforts expended in harmonizing these concerns.

These remarks have necessarily been broad since I have aimed to do no more than encourage a quest for a new public policy toward pension funds. If Congress should determine to pursue that search, I would be pleased, if called upon, to attempt to be more specific, and to assist the Members of the Subcommittee in any way I am able.

TESTIMONY OF IRA M. MILLSTEIN
APPENDIX A

Something Basic Is Wrong in America

By AKIO MORITA

A SERIOUS look at the composition of the United States-Japan bilateral trade imbalance shows that the United States is becoming highly dependent on Japanese high-tech industrial products.

From 1982 to 1988, the volume of American imports of consumer durable goods from Japan fell 34 percent. This decrease is largely offset, however, by an increase in American imports of capital goods, like high-tech devices, components and equipment American industry needs to make its own products. Imports of machinery over all increased 82 percent. This is one reason why the total United States-Japan trade imbalance does not appear to improve.

It is, of course, an indication of the integration of the United States and Japanese economies that for many products design and final assembly are done in the United States while manufacturing is carried out in Japan or elsewhere. But America's loss of competitiveness in so many areas of high-tech manufacturing suggests that there is something fundamentally amiss in American industry. If the United States loses too much of its high-tech manufacturing base, it also loses its ability to be a technology leader in the coming century.

This is something Americans should be concerned about. But it is also a global concern that American industry regain its competitiveness.

The real key to competitiveness lies not in trade policy and protection of high-tech industries, but in increased investment, strengthened research and development and workforce development. Basic education and on-the-job training need to be improved.

My most basic message is that the United States Government and American companies should shift their time horizons. Investments are needed today that will pay dividends in 10, 20 or 30 years. The short-term orientation of corporate management in the United States encourages the neglect of long-term investment vital to industry, depriving it of the ability to create attractive products. Both Senator Lloyd Bentsen and Richard G. Darman, director of the Office of Management and Budget, have recently made similar points.

Camera Press

Akio Morita (l.), and Edward L. Hennessy.

Seeking hasty results is dangerous in manufacturing.

Mr. Darman courageously used the phrase "now-now-ism" to accurately describe the American obsession with getting quick results at the expense of long-term considerations.

Seeking hasty results is especially dangerous in manufacturing industries, where it takes 10 years to develop a new technology, 10 more to apply it to a new product, and maybe another 10 to turn that product into a profitable business. Patience, consistency and continuity are required. Yet the financial community seems to concentrate on 10-minute time frames.

In the financial sector, now-now-ism causes currency fluctuations that undermine the future-oriented manufacturing industries and weaken the global economy. Because manufacturing is fundamental to a healthy economy, the most important role of the financial community should be to provide manufacturers with the best economic atmosphere.

THERE are two other challenges to be considered with regard to international competitiveness and the trade imbalance. First, successful international companies must emphasize localization and globalization of business operation.

Localization is the first important step for a global enterprise. That is why I established the Sony Corporation of America in 1960 with local management and with an ongoing commitment to manufacturing, research and development, and engineering activities in the United States.

Through localization we can get the best talent and performance available in each location. If we accomplish this locally, we can achieve the full potential of our global work force. But we must also globalize operations, conducting our worldwide operations with a common business philosophy. One reflection of this global localization at Sony is that we have named an American and a Swiss national to our board of directors.

The second challenge is one faced collectively by all industrial nations. It is obvious that we need larger markets for the future development of the global economy.

To this end, I agree with Prime Minister Lee of Singapore. The countries of Southeast Asia must become consumer societies, and Japan too must exercise a powerful import pull. Then America, Europe and Asia — including Japan — could be three important regions contributing to worldwide economic development.

People in business face many challenges. If we cannot offer attractive products that satisfy customers, and cannot afford long-term investment, it will be difficult to succeed. But no nation, and no company, can by itself address the compelex issues of competitiveness, trade imbalances and long-term commitment to manufacturing that lie at the heart of commerce. On the business map there can be no boundaries. ■

Akio Morita is chairman of the Sony Corporation.

The New York Times
October 1, 1989
Section 3, page 2

Japan's Market Is Closed Drum Tight

By EDWARD L HENNESSY Jr.

JUST over a decade ago, the company I work for decided to enter the Japanese market with a high-tech amorphous metal alloy we had developed in our New Jersey laboratories. Determined to avoid the pitfalls that had doomed the efforts of so many other foreign companies on Japanese soil, we named a Japanese-born and educated executive who worked for Allied-Signal Inc. in the United States to head the effort in Tokyo. Fluent in the language and schooled in the nuances of doing business in Japan, he seemed an excellent choice to help us establish a Japanese beachhead. He also had the advantage of a joint venture with a Japanese business group, and a long-term commitment from Allied-Signal.

Our man in Japan recently returned home — frustrated and empty-handed — after running headlong into one roadblock after another. We are determined to keep at it, and recently managed to obtain a Japanese patent that we filed 12 years ago. But we are repeatedly cautioned by Japanese insiders that our aggressive efforts to compete are disrupting the harmony of their markets.

There is no denying that Japan is a virtually impenetrable market for many foreign businesses today. My company is certainly not the first — nor the last — to learn this firsthand. As an American business executive, however, my intent is not to condemn the Japanese, nor tell them how to manage their country. Instead, I feel we must make a genuine effort to understand the Japanese way of doing business as a crucial step toward correcting our trade imbalances.

Clearly, we can't delude ourselves into thinking that Japan plays by the same economic rules and imperatives as the rest of the world. In the course of achieving its astounding postwar success, Japan developed its own distinctive views of competition, open markets and free trade. Indeed, national economic development and security are placed well ahead of global interests. As Jacques Delors, president of the European Commission, noted recently, the very idea of trade reciprocity simply is not understood by Japanese companies.

The current $52 billion trade imbalance between the United States and Japan confirms what many Americans have suspected about Japanese trade practices. That deficit is barely down at all from when the dollar was strong, while over the same period the American trade deficit with Europe was cut in half. A recent Business Week/Harris poll showed that by a 3-to-1 margin, respondents felt that Japan's economic challenge posed a greater threat to America's future than the Soviet military. It appears that mutual suspicion is fast becoming an unfortunate fact of life between our two countries.

The severity of this country's trade gap certainly cannot be ignored or minimized. We should be working hard to erase it by making low-cost, high-quality products that the world needs, and is willing to buy. All too often, the United States has failed to turn its scientific excellence into marketplace winners fast enough and convincingly enough. We have lagged seriously behind not only Japan, but other countries as well.

Only recently did Allied-Signal receive a patent filed in Japan 12 years ago.

A growing number of American companies are facing up to the problem. They are forming teams of marketing, manufacturing and research and development people at a project's earliest stages. Such collaborative efforts get products into the market much faster.

American companies are also awakening to the fact that to be competitive in the 1990's, they must embrace the long view. That is, they must respond to the need for long-term investment in research and development and for risk-taking strategies that position their companies in new markets and technologies — and not be overwhelmed by the cry from the financial community for short-term profits and dividends.

AS American companies address their needs at home, however, so must the Japanese face the fact that they are widely perceived throughout the world as a protectionist nation. This perception — whether based on fact or misunderstanding — and the resentment it spawns, harms the global marketplace.

But recriminations and external sanctions are not the way to go. Change must be internal: Japanese executives and policy makers must recognize and accept the fact that the world needs to do business with them.

A book published earlier this year in Tokyo, and co-authored by Sony's chairman, Akio Morita, is entitled, "The Japan That Can't Say No." Instead of a Japan that can say no in its relations with its trading partners, I believe the world urgently needs a Japan that can say yes — yes to open markets, to a mutuality of benefits, and to greater understanding and cooperation among nations.

The global economy is fast unfolding, creating opportunities for countries and citizens on every continent. But without the active support of all the free market nations, that opportunity could be lost. ■

Edward L. Hennessy Jr. is chairman and chief executive of Allied-Signal Inc.

The New York Times
October 1, 1989
Section 3, page 2

TESTIMONY OF IRA M. MILLSTEIN
APPENDIX C

OUTLINE OF MAJOR FACTORS CONCERNING THE POWER OF PENSION FUNDS; SOCIETY'S INTEREST IN PENSION FUNDS; AND THE LEGAL FRAMEWORK UNDER WHICH PENSION FUNDS OPERATE

I. Pension Funds' Power.[1]

  A. Assets under management by all types of institutional investors have experienced enormous growth exceeding $5 trillion in 1988.

    1. In 1988, all categories of institutional investors held assets in excess of $5 trillion, which represents an increase in excess of 14 percent per year from the $2.1 trillion in assets they held in 1981.

    2. All types of institutional investors have increased their share of ownership of all outstanding equities from 38.5 percent in 1971 to approximately 44 percent in 1988.

  B. Public and private pension funds account for the largest share of institutional investor assets, and by 1988 held in excess of $2.3 trillion in assets.

    1. In 1988, the more than $2.3 trillion in assets held by public and private pension funds represented approximately 44 percent of the assets of all institutional investors.

    2. In 1988, public and private pension funds had holdings which accounted for 24.6 percent of equity markets and 15.3 percent of bond market activity.

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[1] Data from: Dr. Carolyn Kay Brancato, Institutional Investors and Corporate America: Conflicts and Resolutions: An Overview of the Role of Institutional Investors in Capital Markets and Corporate Governance, Prepared at the Request of the Subcommittee on Securities, Committee on Banking, Housing, and Urban Affairs, United States Senate, October 3, 1989.

3. The largest pension funds have a high concentration of economic power. At the end of 1988, the largest 30 public and private funds had holdings of $627.7 billion which represented approximately 27.3 percent of the total $2.3 trillion asset value of all public and private funds, and 39.6 percent of the $1.58 trillion in assets represented by the largest 1,000 funds.

C. Institutional investors own an increasing percentage of U.S. public corporations.

1. All types of institutional investors hold an increasingly large share of the equity of U.S. corporations. In 1988, they held 52 percent of the equity of the top 50 corporations, up from 49 percent a year earlier. They also held 53 percent of the equity in the top 100 corporations and 47 percent of the equity in the top 1,000 corporations.

II. Society's Interest.

A. Beneficiaries/Plan Participants.

Foremost among the stakeholder groups are the beneficiaries or plan participants which include both retired employees to whom the funds owe a current obligation to pay pension benefits, as well as active employees, on whose behalf contributions are made and to whom the funds owe a future obligation.

B. Government and Taxpayers.

1. Federal and state governments have promoted and regulated pension funds to ensure retirement security for their citizens.

See Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C.A. § 1001(a) (West 1975).

"(a) Benefit plans as affecting interstate commerce and the Federal taxing power

The Congress finds that the growth in size, scope, and numbers of employee benefit plans in recent years has been rapid and

> substantial; that the operational scope and economic impact of such plans is increasingly interstate; that the continued well-being and security of millions of employees and their dependents are directly affected by these plans; that they are affected with a national public interest; that they have become an important factor affecting the stability of employment and the successful development of industrial relations; . . . that they substantially affect the revenues of the United States because they are afforded preferential Federal tax treatment; that despite the enormous growth in such-plans many employees with long years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that owing to the termination of plans before requisite funds have been accumulated, employees and their beneficiaries have been deprived of anticipated benefits; and that it is therefore desirable in the interests of employees and their beneficiaries, for the protection of the revenue of the United States, and to provide for the free flow of commerce, that minimum standards be provided assuring the equitable character of such plans and their financial soundness."

2. Governments have provided pension benefit insurance programs through the Pension Benefit Guaranty Corporation. See Title IV - Plan Termination Insurance: Subtitle A - Pension Benefit Guaranty Corp., Pens. Plan Guide (CCH) ¶ 15,310 (Jan. 29, 1988).

3. At considerable cost to all taxpayers, federal and state governments have given significant tax benefits and incentives to encourage employers to voluntarily establish and contribute to pension plans.

a. The tax-qualified retirement plan is exempt from income taxes.

  1) Employer contributions to tax-qualified retirement plans and the income earned thereon are generally exempt from federal income taxes. See I.R.C. §§ 501(a) and (b) (1986).

  2) This exemption from income taxation generally relieves the retirement plans from the costs of tax planning, and eliminates the effectiveness of tax incentives.

  3) This exemption effectively makes the cost of retirement benefits more affordable to employers, thereby enabling corporations to provide greater benefits to their employees.

b. Some states exclude retirement benefits from employees' taxable income.

  1) Employees generally are not taxed for employer contributions to a tax-qualified retirement plan on their behalf until such time as the retirement benefits are received by them. For New York, see N.Y. Tax Law § 612(c)(3-a) (McKinney 1987).

  2) Some states exclude all or part of the retirement benefits from employees' taxable income even once the retirement benefits are distributed to them.

    a) The Supreme Court recently decided that states having disparate tax treatment of state and federal pension benefits are violative of principles of inter-governmental tax immunity. See Davis v. Michigan Dep't of Treasury, 103 L. Ed. 891, 109 S. Ct. 1500 (1989). Accordingly, states now must accord equal treatment to state and federal pension benefits.

b) New York, for example, which granted a 100% tax exclusion on retirement benefits derived from New York State retirement plans, has extended the 100% income tax exclusion to federal retirement plans. See 1989 N.Y. Laws 664.

c) With respect to income derived from private retirement plans, the first $20,000 received by retirees who are 59-1/2 or older is excluded from New York state income tax. See N.Y. Tax Law § 612(c)(3-a).

3) The state tax exclusion provides tax-free income to beneficiaries.

c. Employers are permitted to deduct contributions to a tax-qualified retirement plan at the time such contributions are made.

1) Employers generally are allowed a business expense deduction for reasonable compensation paid to employees, and employees are taxed on this compensation at the time it is received. In effect, employers take a tax deduction at the same time as employees pick up taxable income.

2) Federal income tax law permits employers to take a deduction on contributions to a tax-qualified retirement plan at the time such contributions are made even though employees are not required to include such contributions in their income until such time as they are actually received. See I.R.C. § 404(a)(1)(A) (3-a)(i) (1986).

3) Employers benefit by being permitted to deduct contributions prior to the time employees are taxed. Accordingly, the value of the accelerated tax deduction is a benefit to employers.

C. Employers (as Plan Sponsors).

The creation of pension funds is voluntary on the part of employers. However, by committing to establish these funds, public and private employers take on the dual obligations of continuing to contribute financially to the funds and participating in the selection of fiduciaries for the funds. Employers affect pension funds, as well, by changing benefits and terminating benefits. The continuity and health of the funds is inextricably tied to the health of their sponsors and vice versa.

D. Corporations (as Recipients of Fund Investments).

1. The investment and ownership decisions of pension funds have a significant impact on the economic health and viability of the corporations in which they invest and their respective constituencies, including other shareholders, employees, suppliers, customers, and the communities in which they do business.

2. As corporations restructure to enhance their competitiveness, pension funds become an increasingly important source of capital to finance the restructuring.

See Our Money's Worth: The Report of the Governor's Task Force on Pension Fund Investment, at 14-18 (June 1989).

III. Legal Framework.

A. ERISA, which imposes duties of loyalty and prudence, and exclusive purpose requirements on fiduciaries, does not preclude consideration of multiple stakeholders.

1. ERISA does not restrict fiduciaries from considering only direct benefits to plan participants.

a. Section 404(a)(1) of ERISA provides, in pertinent part:

"(a) Prudent man standard of care

> (1) . . . a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and -- .
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims . . ." 29 U.S.C.A. § 1104(a)(1) (West 1975).

b. The "duty of undivided loyalty" obligates fiduciaries, in pension fund investing and ownership decisions, to act solely in the interest of participants and beneficiaries of the plan, and in no way limits fiduciaries' consideration of matters outside of the plan that impact upon the interests of participants and beneficiaries.

The Department of Labor has interpreted ERISA to permit fiduciaries to consider -- in making investment and ownership decisions -- matters other than direct monetary benefits so long as there is an impact upon the pension fund. *See* Address by Deputy Secretary of the Treasury, M. Peter McPherson, before the *Council of Institutional Investors* (Apr. 4, 1989), *excerpted in* N.Y. Times, Apr. 5, 1989, at D11, col. 5.

c. Case law supports the proposition that fiduciaries may seek more conservative investments to ensure the availability of current funds to pay benefits or may seek more aggressive investments to increase the overall amount of assets available to pay benefits. In selecting the appropriate investment strategy, fiduciaries may consider benefits to persons other than the participants of the plan. See Donovan v. Walton, 609 F. Supp. 1221, 1245 (D.C. Fla. 1985) (pension fund trustees did not breach their duty, in negotiating a lease agreement that benefited a union and did not contain the "best terms" possible for the fund, where "the benefits to the union were parallel to and inseparable from the benefits derived from the fund and its participants.").

B. ERISA did not contemplate the impact of the enormous growth of pension funds on our economy.

1. The functional purpose of ERISA is to ensure that funds are available to be paid to employees upon their retirement, pursuant to the terms of the plans.

a. See, e.g., S. Rep. No. 93-127, 93d Cong., 1st Sess. 9, reprinted in 1974 U.S. Code Cong. & Admin. News 4838, 4845 ("Another major issue in private pension plans relates to the adequacy of plan funding. 'Funding' refers to the accumulation of sufficient assets in a pension plan to assure the availability of funds for payment of benefits due to the employee obligations arise.").

b. See, e.g., 120 Cong. Rec. S29944 (daily ed. Aug. 22, 1974) (statement of Sen. Javits) ("[C]ongress has developed a fair and feasible system of private pension regulation. And under this regulation, private plans will develop more rapidly than in the past because the Congress will have assured that pension promises are kept and reasonable expectations built upon those promises are not disappointed.").

c. See 120 Cong. Rec. H29194 (daily ed. Aug. 20, 1974) ("There can be no security in a pension plan if it is not funded properly. Improper funding whether arising through inexcusable ignorance or outright fraud leads to bankruptcy with the worker being the ultimate loser. This injustice will be eliminated by [ERISA] to insure pension solvency and protect the worker.").

2. The legislative history of ERISA indicates that one of its primary functions is to ensure that fund assets are not misappropriated, diverted or used in a manner that does not further the interests of the plan participants.

   a. See, e.g., S. Rep. No. 93-127, 93d Cong., 1st Sess. 1, reprinted in 1974 U.S. Code Cong. & Admin. News 4838 ("The purpose of [ERISA] is to prescribe legislative remedies for the various deficiencies existing in the private pension plan systems.").

   b. See, e.g., S. Rep. No. 93-127, 93d Cong., 1st Sess. 2, reprinted in 1974 U.S. Code Cong. & Admin. News 4838, 4839 ("[ERISA] prescribes new and stringent rules of conduct required for trustees and fiduciaries administering employee benefit funds, and prohibits conflicts of interest and various specific practices to prevent actual or potential misuse of such funds.").

3. One of ERISA's primary goals was to prevent certain types of abuses, namely thievery and self-dealing.

   a. See, e.g., 120 Cong. Rec. S29932 (daily ed. Aug. 22, 1974) (statement of Sen. Williams) ("Despite the value of full reporting and disclosure, it has become clear that such provisions are not in themselves sufficient to safeguard plan assets from such abuses as self-dealing, imprudent investing, and misappropriation of plan funds. Neither existing State nor Federal law has been effective in preventing or correcting many of these abuses. Accordingly, the legislation imposes strict fiduciary obligations on those who have discretion or responsibility respecting the management, handling or disposition of pension or welfare plan assets.").

4. Legislation did not foresee all the ramifications of pension funds.

   See, e.g., 120 Cong. Rec. H29193 (daily ed. Aug. 20, 1974) (statement of Rep. Perkins) ("I am not convinced that the provisions contained in our conference report are a penultimate solution to all the problems of retirement security for our work force, but it is a grand beginning. There are problems not contemplated in its provisions and we will be busy for many years attacking those problems, as well as strengthening the standards.").

5. ERISA envisioned the plan fiduciaries would take into account long-term considerations. In discussing the establishment of a funding policy for a plan, as required by ERISA section 402(b):

   "[E]ach plan is to provide a procedure for establishing a funding policy and method to carry out the plan objectives. This procedure is to enable the plan fiduciaries to determine the plan's short- and long-run financial needs and communicate these requirements to the appropriate persons. For example, with a retirement plan it is expected that under this procedure the persons who manage the plan will determine whether the plan has a short-run need for liquidity (e.g., to pay benefits), or whether liquidity is a long-run goal and investment growth is a more current need. This in turn is to be communicated to the persons responsible for investments, so that investment policy can be appropriately coordinated with plan needs." See H.R. Conf. Rep. No. 93-1280, 93d Cong., 1st Sess. 41, reprinted in 1974 U.S. Code Cong. & Admin. News 5038, 5078.

QUESTIONS FROM MEMBERS OF THE SECURITIES SUBCOMMITTEE FOLLOWING THE HEARING OF OCTOBER 3, 1989

[The following questions are being sent to each witness who participated in the hearing. You may answer some, or all, of the questions on which you have views. Answers to the questions, as well as any additional discussion or material submitted by witnesses, will be included in the hearing record. We would appreciate your response by December 15, 1989.]

1. For many years, the U.S. corporate system has been one in which ownership of corporations -- by public shareholders -- has been separated from control of those corporations -- by professional managers. The key question of corporate governance has been, "Just how do you align the interests of managers with the public shareholders?" It has been argued that takeovers serve that purpose, by weeding out managers who have not kept stock prices high for their public shareholders. However, some takeovers result in tremendous costs to employees, as well as to local economies. This leads to two questions. Does the fact that we have so many takeovers mean our other structures for accountability -- for example, use of the proxy process -- have failed? Is there a better way to structure our system so that the displacements that come from takeovers and forced restructurings are not necessary?

2. The SEC last examined the question of corporate accountability in a staff report issued in 1980. In light of the dramatic changes in the market over the past decade -- e.g., the growing ownership of equities by pension funds, increased private placements and other private investments, increased takeover and leveraged buyout activity, the adoption of "poison pills" and other defensive tactics, and developments in state law relating to change in control situations -- should we ask the SEC to undertake such a study again?

3. For many years in this country, our markets have been characterized by broad, public ownership. That ownership has rested primarily with individual investors. Individual investors have been an important source of stability, as well as liquidity. Perhaps just as important, when individuals own stock, they feel they have a stake in our capitalistic system and in the success of our economy as a whole. Will there be a place for the individual investor in the markets a decade or more from now? If individuals hold shares primarily through institutions, should we try to keep them involved in the corporate governance process? Or should we relegate corporate governance to the professional money managers and institutions? Do we need to develop a different structure?

4. In his testimony, Mr. Kirby stated, "many professional business managers and institutional investors have done a better job of looking out for their own interests than they have of living up to their responsibilities to society as a whole." As fiduciaries for pension fund beneficiaries, fund trustees are faced

with the dilemma of choosing the short term gains offered in corporate takeovers, or waiting for the long term value of a company to be realized, perhaps for the greater benefit of all shareholders. How, if at all, would you propose enabling shareholders to choose measures for the "greater good" as opposed to serving their immediate individual interests?

5. In a recent article, Harvard Professor Jay Light observed that the evolving system of equity ownership dominated by private positions in the U.S. is beginning to resemble ownership systems in Germany and Japan. Mr. Monks in his testimony stated that, while like Japan, Germany and Great Britain, we have a large portion of our capital in the hands of institutional investors, U.S. institutional ownership groups are not in synchronization with national economic and policy priorities, as is evident in Western Europe and Japan. How do you see the system of equity ownership evolving? Should U.S. institutional owners have goals consistent with national economic and policy priorities?

6. A recent report issued by the New York State Task Force on Pension Fund Investment recommends that a pension investment unit be created to identify, screen and diversify the geographic and credit risk of investments aimed toward economic development. The report also recommends that additional guarantees for pension funds trying to carry out new economic development-oriented investment policies be provided. A recent Wall Street Journal article reported that the treasurers of 10 states are "pledging to invest public pension money to spur each other's local economies and defend hometown companies against hostile takeovers." Mr. Monks and other experts have said they are troubled by the idea of using public or private pension assets for goals unrelated to the traditional standards of risk and returns. Please comment further on these suggestions.

7. In a recent article, Professor Michael Jensen of Harvard suggested that for certain industries the traditional corporate form, with centralized management and dispersed ownership, is outmoded and inefficient. Further, he suggested the model corporate form may be represented by the recent incidences of leveraged buyouts, i.e. -- managers of the company should also have a principal ownership stake. What are your views? If you agree, please comment on why many companies "go public" a short time after an LBO.

8. Does the recent evolution of private illiquid investments and pools of equity capital make the U.S. public markets less essential for institutions? What do you see as the role of the public markets over the next decade? Beyond the next decade?

9. If more and more institutions use indexing, and only established companies are part of the market indexes, what will be the implications for small companies seeking to raise equity capital through the public markets?

10. By definition, investors in market indexes do not invest in an individual company with a particular concern about performance, as long as the index is

appropriately tracking the broader market. As stock prices rise and fall, the index is adjusted and the stock values are reweighted. What are the implications of a market with the majority of its institutional money invested in market indexes? What will drive individual stock prices up or down if institutional money is invested without preference to particular stocks or industries? Will the market lose "efficiency" as a means of evaluating individual corporate performance?

11. Mr. Feldman testified that, with the large amounts invested in the market, many institutional investors simply do not have the time to examine companies on an individual basis. Thus, institutional investors have turned to greater use of indexing. At the same time, however, they argue for greater access to the corporate proxy. Is there a contradiction here?

12. Many corporate managers have said institutional investors do not appropriately value the long term earning potential of their capital investments. In your view, how can corporate management more effectively communicate that value and, in turn, see that value more accurately reflected in a company's stock price?

13. In your view, what accounts for the difference in share prices and the "control premium?" Some economists in the past have said the control premium reflects the market's expectation of the value of a company under new management. More recently, it might be suggested that the control premium reflects the difference in value of a company as a going concern, versus a company's break-up value. What is your view?

14. Mr. Monks, in his testimony, referred to the race to the bottom in state laws affecting corporate governance. Do you believe there should be explicit federal minimum standards with respect to shareholder voting rights and other shareholder rights issues?

15. A study prepared for the Subcommittee by Dr. Carolyn Brancato showed dramatic differences in the portfolio turnover rates for various institutional investors. Some funds had turnover rates of over 300%; others had turnover rates of less than 10%. The study showed that bank trust departments had the lowest average turnover; mutual funds and investment advisers had the highest. What does this tell us about the "short term" versus "long term" argument, and what do you believe accounts for such a wide disparity in turnover rates? Do you believe we need more information in this area? What kinds of questions should be asked?

16. A survey released by the Labor Department on March 4, 1989 reported that 39% of the investment managers interviewed said they had no responsibility for voting the proxies of the shares that they managed and that they did not know who did. Should this be a cause for concern?

17. There have been suggestions that ERISA should be amended to permit fiduciaries a wider range of choice with respect to their investment decisions.

What are your views?

18. In view of the changes in the market and in corporate governance resulting from increased institutional participation, what, if any, specific changes would you propose to the Federal securities laws? To ERISA?

19. Although the hearing focused primarily on corporate governance issues, recent stock market activity has rekindled questions raised in October, 1987 about the impact of institutional investors on market volatility. What are your general views on this issue? The hearing focused on the responsibilities of institutions with respect to corporate governance. Do institutions have new responsibilities with respect to their trading activities?

20. Institutional investors have been criticized for having a short-term investment horizon. Is this a valid criticism with respect to any class of institutional investor? If so, what specific steps would you suggest to encourage longer-term holding of equity securities?

21. Does a trustee's or investment managers' obligation to act in the beneficiaries' best interest require that funds be actively managed? If so, why? Is there any empirical evidence showing that for larger funds, in the aggregate, active management yields above-market returns? Is passive management or indexing contrary to fiduciary responsibilities?

22. How does corporate activism on the part of institutional investment managers contribute to higher fund performance? If an investment manager felt that a company and its management was underperforming, would the fiduciary obligation to maximize value mandate that the shares be sold?

U.S. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

RESPONSE TO QUESTIONS
FROM MEMBERS OF THE SECURITIES SUBCOMMITTEE
FOLLOWING THE HEARING OF OCTOBER 3, 1989

IRA M. MILLSTEIN

Response to Question 1

I do not believe that takeovers and forced restructurings necessarily signal that our structures for accountability are faulty. On one hand, many takeovers and LBOs have nothing to do with accountability, corporate performance or the ousting or invigorating of poor management. Instead, many such transactions have solely financial goals, sometimes merely reflecting the mortgaging of a corporation's future cash flow. This is done to support the debt service payments required by the highly leveraged capital structures necessary to generate the certain current cash-out of today's public stockholders that takes place in a corporate takeover. Peter Rona put it well when he noted that "[t]he very foundation of the LBO is the current actual distribution of hypothetical future cash flows . . . shifting the risk of future uncertainty to others . . . ." LBOs may inherently constitute a short-term economic strategy when managers intend to sell the companies they control back to the public in four or five years. Research and development and capital spending would appear to be unlikely priorities for the short-term owners of these heavily indebted companies. On the other hand, such transactions, in particular cases, many effect a needed restructuring that can produce economic efficiencies. And, indeed, some management LBO's were defensive; created in the face of LBO's threatened by others.

Although Mike Jensen and others view takeovers and LBOs as the cure-all for lazy managements and poor corporate performance, I don't believe that leveraged buy-outs or takeovers are the uniform solution to all problems of corporate governance. Jensen and others may be correct that the current level of conflict between management and shareholders is divisive to the goals of our corporations and should be resolved, but as I discussed in my recent response to Jensen, published in the Harvard Business Review and annexed hereto, we don't need to eclipse public corporations by relying on "LBO Associations" to achieve a congruity of interest between management and owners and management excellence.

My written statement of November 14, 1989 to the Joint Economic Committee of Congress, which I have annexed hereto, recommends that we encourage managements, boards and institutional shareholders -- mutually dependant groups --

to interact in a manner that creates real value over the long term for shareholders and supports the corporation in its struggle for global competitiveness. By focusing on improved and increased communication between managements, boards and institutional investors, aimed at improving corporate performance, we can achieve better and less traumatic results than those who advocate takeovers and LBOs as the cure all for lethargic managements.

Response to Question 3

Over the past fifteen years, shareholder populations have been in a state of flux. The number of private individual investors has decreased significantly, while a relatively smaller group of large institutional investors are attaining a dominant role. In addition to the shift in numbers, we are witnessing a shift in the locus and concentration of power as shareholders have changed from a very diverse group of individual investors, without much power, to large institutions who frequently adopt similar investment and shareholding patterns, react to situations in a like manner and may come to act together to influence corporate policies.

Many believe this shift in share ownership -- from individuals to institutions -- is also responsible for a significant change in investment and ownership attitudes. As your question notes, individual investors have been perceived as bringing stability to the markets. This stability may result for a variety of reasons: perhaps because individual investors "feel they have a stake in our capitalistic system and in the success of our economy as a whole," as your question suggests; or perhaps because of "irrational" considerations such as an individual's particular allegiance to a local company or product; or perhaps because individuals place more emphasis on certain investment criteria such as value and long-term growth and less on others such as "market timing." Whatever the reason, individual investors have been seen as a stabilizing factor, generally supportive of corporations pursuing long-term goals not generally preoccupied with short-range fluctuations in market price.

On the other hand, institutional shareholders are perceived -- largely by corporate management -- as transients who tend to seek market gains and thereby inhibit managements' ability to take risks and innovate -- the core function of the private sector, if it is to remain globally competitive. Whether or not in fact institutional funds act as transient shareholders who always seek quick gains is less important than the fact that management and others perceive them as investors whose short-term focus hampers effective governance.

If U.S. corporations are to remain competitive, large institutional shareholders should adopt investment and ownership attitudes that reflects responsible monitoring and support of long-term performance. To become responsible long-term owners, institutions will need to take some role in governance, including voting their proxies and supporting risk and innovation, all aimed at improving performance. With control of enormous assets concentrated in relatively few hands, institutional investors are ideally positioned to become participants in corporate governance. They can assist (through support) corporations in developing strategies to promote risk-taking and innovation that ultimately will make our U.S. corporations stronger competitive players in the marketplace. A different governance model need not be developed in order to achieve this goal.

In a securities market that is increasingly being dominated by institutional shareholders, individuals are finding their role by investing in the markets through institutions such as mutual funds. Through such institutions, individuals can benefit from the knowledge and expertise of those who are more attuned to the complexities of the current investment environment. However, the individual who invests through an institution will have difficulty playing a role in corporate governance. This makes it even more important that all institutional investors take a role in governance.

Response to Question 5

The formidable economic progress and development of both Japan and West Germany demonstrate that congruence of interests between investors and corporations yields immense rewards. We at the New York State Task Force on Pension Fund Investment have recognized that as pension funds -- creatures of public policy -- amass outcome-determining power in the financial markets and in corporate governance, they should have regard for the consequences of their investment and ownership decisions. These consequences include, of course, impacts upon national economic and policy priorities. For example, in light of their tax-exempt status, pension funds should demonstrate to Congress as well as state legislatures their increasing awareness of the impacts and consequences of their economic power, as that power continues to grow. If pension funds do not voluntarily consider those impacts and consequences, I have no doubt that legislatures may ultimately help them.

For a further discussion, see my written statement of October 3, 1989, pp. 2, 11-12.

Response to Question 6

Mr. Monks and others assume that broader economic considerations and risk and return analysis are mutually exclusive. The Report of the Task Force on Pension Fund Investment does not suggest this. In fact, the proposal to create an investment unit was intended to provide government assistance in identifying economic development targeted investments which would be attractive to pension funds from a risk and return respective. Further, the Report does not advocate social or suboptimal investing. To make this point absolutely clear, the Task Force on Pension Fund Investment included the following language in its Report:

> The Task Force does not in any of its recommendations, propose direct subsidies, concessionary investments by pension funds, abnormal risk-taking, or any other non-economic investments, to achieve economic development.

At this moment, the New York Task Force on Pension Fund Investment is readying a report making more specific suggestions as to targeted investments which will not be sub-optimal or concessionary. Indeed, many public funds are devoting considerable thought to this type of investing and organizations such as the Institute For Fiduciary Education in Sacramento, California, are sponsoring research and seminars on the subject. Suggestions for such investing will become more concrete in the months ahead.

For a further discussion, see my written statement of October 3, 1989, at pp. 12-13.

Response to Question 7

Mike Jensen and others advocate the "eclipse" of the public corporation altogether and view the market for corporate control as the solution to all problems of corporate governance. I disagree. See my published annexed Letter to the Editor, in response to Professor Michael Jensen's article entitled Eclipse of the Public Corporation, published in the Harvard Business Review.

Response to Question 10

Concern has been expressed concerning the increasingly popular investment technique of indexing because of its potential impact on corporate performance. Index funds seem to be in vogue, at least in a continuing bull market, but even in a different market environment, they are likely to play an important role. There is a risk that indexing may contribute to a general disregard for performance oriented considerations, since the theory behind indexing is that one buys the entire index as a "basket" of stocks and therefore does not differentiate between companies on the basis of performance. We have too little experience with a heavily indexed market to know whether this will become a serious problem.

If index funds generally do not evaluate corporations on their merits, but rather choose stocks based on their presence in the S&P 500 or some other index, their investment strategy becomes highly abstract, almost mechanical -- they do not make informed decisions to buy or sell on the merits of a corporation's business, strategies, products or managements. More disturbing is the observation that although they are long-term owners, many index funds tend not emphasize long-term performance considerations. For example, to facilitate the market for corporate control, perceived to be bullish for individual company shares as well as the stock market as a whole, index fund managements may routinely vote against poison pills and other measures designed to protect management continuity in the pursuit of long-term business objectives, regardless of management's performance. (Interestingly, some have ignored how many of these "defenses" can augment an "auction" for corporate control and produce greater gains for shareholders.)

While some institutions may act as "traditional stock investors," concerning themselves with the merits of a business and its management over the long term, it is becoming increasingly clear that the largest institutional funds -- by virtue of their size and investment needs -- simply do not have the capacity by themselves to invest major portions of their portfolios on a traditional basis in equities. Accordingly, they must and will continue to act through intermediaries, which are likely to include index funds. Methods, therefore, should be developed whereby index fund managers, to some extent, can monitor and support good corporate performance.

Perhaps index fund managers should be urged to pay more attention to voting proxies, knowledgeably. Or perhaps index funds should pass voting responsibility to someone better prepared to evaluate directors, managers and overall corporate performance. Whatever the solution, this issue of how index funds should impact on corporate performance will be a challenge which we must address in the 1990's.

Response to Question 15

The Brancato study refers to some limitations in the use of turnover data to discern "short-term" trading patterns. Dr. Brancato notes that the available turnover data is based on net positions at the end of each quarter and therefore does not reflect the trades made during the quarter. I have been advised that no data presently is being collected by the SEC or by any industry association or stock exchange which clearly defines how much stock is being held and for what period. Such data would be necessary to understand whether a chronic short-term investment attitude exists among some or all institutions.

For example, the significant variations among institutions revealed by the available turnover data indicates that many large pension funds have very low overall turnover. But this is not a definitive indication as to whether the turnover for a portion of their portfolio, e.g., actually managed portfolios, focused on change in corporate control stocks, was very high, while the remainder, e.g., index funds, was low. It would be necessary to track specific trading patterns, and perhaps relate these to the compensation patterns and hiring practices applied to investment managers, to obtain a more complete picture of institutional investor trading patterns.

Response to Question 16

Proxy voting is an integral part of plan asset management. Yet the Labor Department survey, discussed in this question, which reported that 39% of the investment managers interviewed said they had no responsibility for voting the proxies of the shares that they managed, suggests that some investment managers appear to be lax about voting their proxies. I believe widespread failure to vote proxies is a symptom of a greater problem, an inattentiveness to corporate governance. As I discuss in my response to Question 3, institutions should become responsible participants in the governance process with the aim of encouraging good corporate performance. Voting proxies is the principle manner by which institutions can participate in governance. Therefore, if failure by fund managers to vote proxies is caused by their lack of knowledge and participation in governance of the corporations in which they invest, there is genuine cause for concern.

Response to Question 17

To the extent that barriers to taking a broader long-term view of the interests of beneficiaries and to considering the impact of their investment and ownership decisions, reside in interpretations of ERISA and other current legal standards governing pension fund decision-making, they should be removed. But, I do not believe the statutory provisions of ERISA need present a barrier. It is the attitude of fiduciaries that presents a more formidable barrier to pension funds broadening their outlook. Therefore, I do not believe that, at this time, legislation is necessary for pension funds to adopt a broader view.

As we indicated in the Task Force Report on Pension Fund Investment, the fiduciary standards imposed by ERISA do not foreclose consideration of the long-term interests of beneficiaries. Nor would I suggest imposing on pension fund fiduciaries legal obligations owed to multiple stakeholders; my recommendation for a broad view of pension fund investment policy is precatory. However, I do believe that clarifying statements by the Department of Labor to the effect that ERISA does not foreclose consideration of the multiple interests of beneficiaries, would be helpful. I emphasize that at this stage, it is not the law but the attitude of pension fund fiduciaries that must change to meet the challenge posed.

Response to Question 22

The maximization of shareholder profit and the maximization of fund assets -- legal models for accountability written for the simpler business conditions of the early twentieth century -- if followed absolutely may lead too often to short-term "asset stripping" and speculative investment strategies. A more appropriate model for our times should stress promoting real long-term economic growth -- optimizing the investment.

Optimizing investments requires more knowledge about individual company performance, and, again, more active management of individual company investments than now appears to be the case. With more deliberation by institutional investors about proxy voting, ownership and investment decisions --all based on better knowledge of individual company performance -- I believe credible corporate managers will be freed of unnatural short-term pressures, thereby enabling them better to plan for the long term.

Ultimately, better fund performance can be achieved through better corporate performance. Institutional investors' actions or inactions can encourage corporations to improve performance by supporting risk taking and innovation, or, alternatively, can discourage long-term corporate growth.

To encourage long-term investment and ownership policies, institutional investors should not only support those strategies aimed at improving performance but must have a method of expressing dissatisfaction with poor corporate performance as well. One school of thought encourages dissatisfied institutional shareholders to express their discontent by selling their shares, removing themselves as owners and forgetting about the governance of that corporation. However, this traditional response to poor corporate performance -- the "Wall Street Walk" -- has its limits.

The Proxy Project Report issued by the Department of Labor last March noted that the "Wall Street Walk" may no longer be a viable option because large blocks of stock owned by major institutional investors may not be disposed of easily. A major institutional investor holding a large block of stock in a particular corporation may have to liquidate its holdings at a "block discount" or over an extended period of time to avoid adversely affecting the market price. Moreover, a widespread following of the "Wall Street Walk" by institutional investors could decrease stock prices and increase overall market volatility and transaction costs.

Recognizing the limitations of the "Wall Street Walk," another school of thought posits -- and I lean toward this view -- that selling stock is not the total answer to poor corporate performance. Although selling a particular stock may be an appropriate response -- either because a good profit has been made and a portfolio strategy satisfied or because the company has no future -- a blanket policy of selling out every time an investor is dissatisfied with a stock's performance, would only serve to depress stock prices and exacerbate market volatility. Moreover, the universal "Wall Street Walk" rule, would mean that institutions would never act within the corporate paradigm to improve poor corporate performance.

Institutional investors should be willing to communicate with the corporations they invest in. And corporations should establish -- consistent with each corporation's own unique structure and culture -- the process by which they can communicate. I believe the process -- and the locus of the discussion --should be expanded well beyond "show and tell" investor relations. There is no need to mandate a particular communication mechanism. Communication may take many forms.

Under most circumstances, communication about performance, or the lack thereof, should be with the CEO and the CEO's designees. However, specific limited instances exist when the institutions might communicate with the board directly. These circumstances include: when management underperforms and is unresponsive to earlier efforts to communicate; when new directors are being nominated; in a change of control situation, i.e., mergers and takeovers; and, to encourage a long-term strategy.

Communication strengthens corporate governance and the public's perception thereof. By focusing on appropriate communication between management, the board and institutional investors, aimed at bettering corporate performance, we can achieve the same results as those assertedly sought by the advocates of LBOs, takeovers and proxy contests, but far less traumatically and with far lower transaction costs and debt.

To enter the process responsibly, institutional investors should not resort to grumbling about the invasion of their fiduciary responsibilities. I am suggesting only that they accept their part of the corporate paradigm -- and play a constructive supportive role in encouraging good corporate performance -- thus, enhancing our country's competitive position.

January 5, 1990

The Honorable Christopher J. Dodd
444 Senate Russell Office Building
Washington, D.C. 20510

The Honorable John Heinz
277 Senate Russell Office Building
Washington, D.C. 20510

Dear Chris and John:

I am responding to your letter of October 17, 1989, which is a follow up to the hearing held by the Securities' Subcommittee on the Impact of Institutional Investors on Corporate Governance, Takeovers and the Capital Markets.

You enclosed additional questions which were submitted by committee members after the hearing, and asked for any further comments I might have. Attached are my responses to several of the questions posed.

I thank you for the opportunity to appear before your Subcommittee and I appreciate your continued interest in these issues which I believe are so vital to our economic future.

I look forward to the possibility of visiting with you and continuing our dialogue on these issues the next time that I am in Washington.

Sincerely,

Andrew C. Sigler

attachment
ACS/sjl

Answers to Questions for Security Subcommittee following Hearing of 10/3/89

ANSWER TO QUESTION #1:

The high number of takeovers does not in any way mean that our other structures for accountability have failed; in fact, most corporate raiders will tell you privately that the quality of management is irrelevant in their decision as to which corporations to target. Other factors such as a steady cash-flow, assets which can be easily divested, over-funded pension plans, and similar economic issues are much more important to the decision. Already, as a result of closer legal scrutiny and experience with changing circumstances, boards of directors are more cognizant of their legal responsibility for overseeing management decisions. Because it seems to be working well and has the flexibility to adjust to change, we should continue to rely on this board structure for accountability.

ANSWER TO QUESTION #4:

I agree completely with the statement of Mr. Kirby that institutional investors are not living up to their responsibilities to society as a whole. There are several ways that we might wean institutional investors from their desire for short-term gains. One proposal might be to do something along the lines that Senator Kassebaum is suggesting, i.e., to impose a tax on the short-term gains of pension funds. Second, I believe it is necessary to clarify ERISA law so that pension fund managers understand that it is consistent with their fiduciary duties under ERISA to wait for the long-term value of a company to be realized in order that beneficiaries may benefit from a healthy economy in the long-term.

ANSWER TO QUESTION #5:

Again I feel that institutional investors have used ERISA as an excuse to justify decisions that are not consistent with national economic policy priorities. While a change in ERISA to clarify fiduciary duties will remove this excuse, this action alone may not be sufficient to change institutional decision making. However, it would be a good first step.

ANSWER TO QUESTION #6:

I believe that it is possible for a pension fund fiduciary to continue to follow the standard requirements related to risk and return, while at the same time to make decisions that spur economic development and long-term growth. The New York State Task Force on Pension Fund Investment did not recommend the abandonment of traditional fiduciary requirements; they simply recommended the addition of other factors to be considered in making such investment decisions.

ANSWER TO QUESTION #7:

I think the recent spate of failures among junk bond financed takeovers and leveraged buyouts is sufficient evidence that Professor Jenson's views are incorrect.

ANSWER TO QUESTION #10:

If the vast majority of money invested in our capital markets is indexed, then only broad economic movements will drive stock prices up and down and there will be no way to differentiate companies based on individual corporate performance. I believe the market has already lost "efficiency" and does not fairly value corporate worth; this situation can only worsen with increased indexing.

ANSWER TO QUESTION #11:

There certainly is a contradiction. Institutional investors only want greater access to the corporate proxy in order to make takeovers and leveraged buyouts easier so that they might continue to seek short-term gains. Many of these investors have fixed, inflexible positions on issues such as poison pills; therefore, they do not look at the broad array of considerations necessary to make a knowledgeable decision on such issues. In my view, when pension funds are indexed, the proxy voting power should not remain in the hands of the index fund, but should return to the beneficial owner who is in the best position to cast an intelligent vote. In the case of pension funds, the proxy vote should be returned to the plan sponsor.

State of Connecticut
OFFICE OF THE TREASURER

FRANCISCO L. BORGES
TREASURER

EDWARD J. FORAND JR.
DEPUTY TREASURER

December 14, 1989

The Honorable Christopher J. Dodd
United States Senate
Russell Senate Building
Room 444
Washington, DC 20510

Dear Senator Dodd:

Included are my responses to the questions from members of your Subcommittee on Securities. I appreciate the opportunity to address the issues which were raised following my testimony at the October 3, 1989 subcommittee hearing.

If you have any concerns with regard to these replies do not hesitate to contact me or Maryellen F. Andersen, Investor and Intergovernmental Relations Director, at (203) 566-7510.

Best wishes for a wonderful holiday season.

Sincerely,

Francisco L. Borges
Francisco L. Borges

FLB/klp

enclosures

cc: Marti Cochran

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RESPONSES TO QUESTIONS FROM MEMBERS OF THE SECURITIES SUBCOMMITTEE FOLLOWING THE HEARING OF OCTOBER 3, 1989

[The following responses are answers to the questions raised during the October hearings before members of the Securities Subcommittee.]

1. The fact that so many takeovers have occurred does not necessarily mean that other structures for accountability, such as the proxy process, have failed. It may, however, mean that the legal system both at the state and national level may have failed. Much legislation today supports the corporation and public opinion frequently encourages such legislation in the mistaken belief that it will protect jobs and keep companies in the state.

When looking at displacements which come from takeovers and forced restructuring, they may in fact be an inevitable part of the capitalistic system at work. One might argue that takeovers occur because acquirers may see value in particular situations far and above what current managers are able to produce.

2. Without question, the SEC should be asked to make a study as to the total question of corporate accountability and should focus on the impact and the influence of pension fund ownership and that influence on the market and developing corporate governance trends.

3. One has to seriously question if the individual investor will play any role in securities markets ten years from now by himself. His interests will largely be reflected by managers who focus their efforts on pension funds and large pools of capital. It is difficult to imagine that individuals will get significantly involved in the corporate governance process with their only ownership being through the pension funds. Perhaps a new system does need to be addressed. Accountability to pension participants may well have to be formalized in terms of response to moral, ethical and business questions, either by informing participants

as to positions and philosophy or through a concerted effort on the part of the manager to reflect constituency concerns.

4. One might very well agree with Mr. Kirby's statement that many professional business managers and institutional investors may have done a better job of looking out for their own interests than they have of living up to their responsibilities to society as a whole. Short-term versus long-term gain is critical and the recent AMR/Trump proposal is an excellent example of the struggle investors have of choosing between long-term and short-term factors. It is difficult for shareholders to choose measures for the greater good. It is a sophisticated concept based on in-depth analysis and judgments relative to market position. One possibility of enabling shareholders to choose this measure for their greater good would be through the proxy process thereby assuring a vote of confidence to current managers and their program if that in fact is warranted.

5. The question as to whether U.S. institutional owners should have goals consistent with national economic and policy priorities seems at least on the surface moot. Market volatility, the impact of economic conditions, trade surpluses, etc., have an effective and immediate impact on markets and subsequent return. It is difficult to see under the current system that goals can be significantly different from those of society at large.

6. Legalities will probably prevail on the issue of whether or not to pledge public pension money to spur local economies and to defend hometown companies. Only now are we beginning to see significant decisions by courts ruling on prudent man behavior and fiduciarily responsible actions on the part of investors. State laws vary and questions arise relative to tax-free status if funds are used for specific purposes, and we seem to be in the very early stages of any definitional response to the questions.

7. Companies go public a short time after an LBO frequently to capitalize on undervalued assets. Additionally, one must look carefully at the traditional structure of corporations and could conclude that the present system of centralized management and diverse ownership may very well be outmoded and inefficient. For example, perhaps a more realistic approach is to provide broad ownership by employees and others closely associated with the company, thereby enhancing incentive, improving quality, meeting competition, and ultimately enhancing the effectiveness of industry as a whole.

8. Public markets have proved to be effective and enduring institutions. Without question, some restructuring of the system may well need to occur, but the efficient market appears as alive and well today as ever despite the fact that the players may have changed -- individual to institutional. The working of the markets and their ability to respond to changing economic, political and international events bodes well for their continuance.

9. Small companies may need to rethink their approach to financing in view of many of the forces acting upon corporations both large and small today. It may very well be that in the future equity capital will be a thing of the past for small companies and that capital from public markets may be hard to attain and that financing will be largely private and increasingly difficult to attract. Implications should also be considered as to the impact on venture capital.

10. It is hard to conceive of 100% of a pension fund's assets being geared to market indexes. There will always be room for a portion of a portfolio to be actively versus passively managed. The huge size of investment portfolios in the pension and related areas and the desire for performance in excess of the index may in fact bode well for markets, particularly in the small cap area.

11. While Mr. Feldman may be correct that institutional investors do not have the time to examine companies on an individual basis and institutional investors have turned to a greater use of indexing, the proxy is one point at which they can examine closely a company's actions and style. It also serves as an alert system to unusual forms of behavior which allow the investor to select areas for further study and in-depth analysis and, therefore, there is no specific contradiction.

12. Corporate managers must do a better job in terms of communicating the value of their companies, but the responsibility also lies with the investment community at large to be totally responsible, analytical and objective in their appraisal of the value of a company and the subsequent relation of that value to stock price.

13. I would concur with the economists who state that a controlled premium does reflect the market's expectation of value and a combination of what that value could be under new management, effectively leveraging the assets of the company.

14. Perhaps no better way of controlling the current trends in business today can be enacted than federal minimum standards for governance issues. The ridiculous movement of corporations from one state to another in order to enhance their positions via state level securities law should be a clear indication that some common ground needs to be established for the governance of corporations.

15. The sharp variation in turnover rates for institutional investors is reflective of style and pressures for quick returns. The disparity is a clear indication of the differences in short-term versus long-term philosophy. Obviously more questions need to be asked and more information compiled. One does in fact wonder if one of the key areas of questioning should not center on fiduciary responsibility and the prudent man law and the use of securities as commodities.

16. The shocking statistic that 39% of investment managers had no responsibility for voting proxies and did not know who did is indeed a cause for concern. The proxy statement is an important document. It is another major source of information and insight into corporate management which, in conjunction with the annual report, 10-K, and 10-Q reports, can give significant information and understanding of corporate activity.

17. Relative to changes in ERISA permitting a wider range of choices with respect to investment decisions, one can support this theory if the question applies to portfolio diversity. The huge consolidations of capital within specific portfolios requires a spread of risk throughout many diverse areas and does in fact support a wide range of choices. If the implication is, however, that ERISA law should be loosened to accommodate increased flexibility, then one would have to question its feasibility and also approach it from an aspect of accountability as well.

18. No comment.

19. The question of market volatility and the impact of institutional investors is critical. Perhaps one of the most critical issues, however, concerning market volatility centers on the wide use of programmed trading. On two occasions in recent history we have witnessed the significance of programmed trading on the market and investors. One has to seriously question how broadly such techniques can be used. Institutions do have new responsibilities with regard to trading, ensuring that conflict situations do not exist and that the trading techniques used do not have a negative impact on overall market conditions.

20. Institutional investors do, in fact, seem to have shortened their time horizon as increasingly they are competitively ranked on a monthly, quarterly and annual basis, and in order to survive more and more are focusing on shorter and shorter time frames. The pressures are extraordinary and both the funds and the

managers seem to encourage what may be a negative trend. Development of philosophies which focus on asset allocation coupled with time-weighted returns may be effective in countering this trend.

21. Passive management is not in fact contrary to fiduciary responsibility, but is true only if a portion of the portfolio is actively managed (30%) at which level it should be able to provide competitively positive results consistent with fiduciary responsibility.

22. Corporate activism on the part of institutional investment managers certainly can contribute to higher fund performance. As managers become more knowledgeable about companies, they can focus more and more on the workings of the company -- its board of directors, the processes for control, the techniques used for attracting and keeping management which, coupled with an understanding of the company's business and goals, can certainly contribute to stimulating managements to do their best job with realistic compensation and insurance that the shareholders' interests are a key part of long-term strategies. Increased activism on the part of institutional investment managers should be encouraged, tracked and evaluated.

AT&T

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December 20, 1989

The Honorable Christopher J. Dodd
Chairman
Subcommittee on Securities
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Dirksen 534
Washington, DC 20510

Dear Senator Dodd:

I would like to thank you once again for the opportunity to participate in your October 3, 1989 hearing on the impact of institutional investors on corporate governance, takeovers, and the capital markets. Attached are my comments on the additional questions you sent following the hearing.

I hope these comments will be helpful, and that CIEBA will be part of your further debates on these issues.

Sincerely,

D.P. Feldman

Attachment

RESPONSES TO QUESTIONS FROM MEMBERS OF THE SECURITIES SUBCOMMITTEE FOLLOWING THE HEARING OF OCTOBER 3, 1989

David P. Feldman, AT&T Corporate Vice President
Chairman
Financial Executives Institute's Committee on Investment of Employee Benefit Assets

1. In economics, there is a cost to corporations' shareowners -- called an agency cost -- associated with the business being run by managers who are not owners. Agency costs arise from the divergent economic interests of owners and non-owner managers. Agency costs would be eliminated if the economic interests of owners and managers could be aligned.

Many U.S. companies are managed in such a way that their agency costs are quite low. It is also possible that some are not. It is my opinion that our existing structures for accountability have generally been effective in minimizing agency costs. Where there is evidence to suggest otherwise, the Board of Directors should be actively involved in seeking a solution; the proxy process should act as an insurance policy representing the shareowners.

With regard to takeovers, I do not believe that most takeovers are caused by failure of the accountability structures, but rather they reflect differing judgements about the valuation of the ongoing businesses and their assets: those who seek to buy a company most often believe that they can run the business more profitably than the existing management team. In some cases, the potential buyer may be right, and the takeover serves to re-rationalize the system. Whether or not that is always true, there is evidence that the market system is working over time to correct for any excess and to minimize agency costs in the ongoing operation of public companies; a primary example is the trend toward less diffused ownership, which can allow for more active and knowledgeable "watchdogging" by shareowners.

2. Boards of Directors are becoming much more sensitized to the need for accountability, and the issues are being dealt with, both by individual companies and through forums set up by various organizations to air differences and seek solutions. It is not clear that a study by the SEC would add to any general enlightenment on the subject.

If such a study is undertaken, I urge Congress to be aware that there are in many quarters strong pre-conceptions about these matters, some of which are based on allegations rather than fact. It is important that Congress assure itself that a study of these critical issues would not be based on anything other than fact.

3. I believe that individual investing in individual stocks will continue to have a significant role in the capital markets. Individuals

are still heavily represented in the markets; AT&T, as an example, has some 2.5 million individual shareowners.

At the same time, I believe that individual investors will continue to migrate toward investing in the stock market through intermediaries (such as mutual funds, pension funds, etc.) and away from investing as individuals in individual stocks. Rather than a negative development for the individual investor, it should be seen as a positive one.

As technology has collapsed market movements that in the past occurred over extended periods of time into much shorter time periods, investors have necessarily been made aware that investing should not be done casually and without the benefit of serious study. Most individual investors simply do not have the time, the expertise, or the resources to perform good fundamental research on their prospective investments; investing through professional intermediaries allow these investors, in most cases at minimal expense, to reap the benefits of research staffs and professional money management. These intermediaries also offer the benefit of diversification -- basic to any prudent investment strategy -- which many individual investors do not utilize sufficiently to protect themselves against investment risk. Rather than try to force the market into a form that is less risky for the non-professional investor, I believe that attention should be given to making mutual fund information and disclosures clearer, more complete, more easily understood, and more readily available.

The increase in the use of intermediaries for individuals' investment activities has also, through pension funds, provided retirement income security and contributed heavily to national savings.

On the corporate governance question, I believe that the professional investor who makes the investment decision, and has most knowledge of the company, is the one most qualified to make those judgements. Returning that power to the individual investor in a mutual fund would mean that individuals with less knowledge of the company would be making governance judgements. I do not think that is beneficial for the accountability issue, and may even exacerbate the problem by creating another layer in the agency cost: the company's management would have a mutual fund manager as an owner, and an individual investor who did not buy the stock making corporate governance decisions. Some mutual fund investment firms are becoming more active on this front; for example, Fidelity recently announced a change in its prospectus that would allow the firm to become more involved in the corporate governance process.

4. Such measures would be unnecessary, in the case of choosing between short-term gains or longer-term value. ERISA does not require choosing the short-term gain, and most pension fiduciaries approach such a decision with the aim of capturing the greater long-term value for the beneficiaries. That may mean, as in the example cited in the question, taking a tender in a takeover, or -- if management is credible and has a

viable long-term plan for greater value -- waiting for the longer-term value of the company to be realized.

"Enabling" shareowners to choose measures for the "greater good" may be more problematic. For investors in general, there are a variety of factors taken into account in the investment decision. A primary one is that there must be an expectation of receiving a return commensurate with risk taken to induce investment, regardless of the "greater good." For private pension funds, ERISA is clear that the fiduciary must invest for the exclusive benefit of the plan participants, and I support that. To dilute that directive with other considerations such as investing for the "greater good," however laudable the various goals might be, could quickly have extremely dangerous implications for the security of pension benefits. But we operate in the freest market system in the world, and one of the most attractive aspects of that system is that it itself promotes the "greater good" by ensuring that funding will follow attractive investments.

Having said that, it is important to note that ERISA's exclusive benefit rule is consistent with not making investment decisions that might damage the markets or the economy over the long term. If we made decisions that would do so, we could be doing a disservice to our fiduciary duties by damaging our future investment opportunities.

5. I would agree that both institutional ownership and private ownership of corporations are increasing. As for the goals of institutional investors, I can speak only for pension funds, and do not believe that there is an inconsistency between our goals and national economic and policy priorities. Our goal is to maximize the long-term economic interests of our beneficiaries. To go further than that, however, and attempt to mandate any particular type of investment regardless of its economic soundness could damage retirement income security and fail to promote the optimal long-term outcome.

Attractive investments will not suffer for lack of funding. The free markets work over time, and investing to maximize the long-term benefit of the pension beneficiaries will ultimately redound to the benefit of the national economic and policy priorities.

6. I agree with Mr. Monks, primarily for the reasons outlined in question 4 with regard to promoting the greater good. Pension funds are not and should not become the arbiters of which social and economic agendas are worthy of funding and which are not. Our singular role is to ensure that our participants (6 million represented in CIEBA) receive the pension benefits they have been promised.

7. I agree that corporations are more efficiently and profitably managed either if managers are owners, or if the economic interests of managers and owners are congruent. (See question 1.) Once a company is taken private, and agency costs are shed, the owner/managers sometimes "go public" again in order to reap the profits of ownership. A problem

that may arise, if after "going public" the managers of the business are no longer the owners, is that agency costs may creep back in.

I think, however, that we must keep the privatization trend in perspective. By far the predominant form of all businesses in this country is and has long been small, private, and owner-managed, and LBOs represent only a small part of large corporate ownership. Many private companies "go public" for any number of reasons: to raise new capital for growth or redeployment of assets, for example. Trends may ebb and flow with market conditions, but for large companies in the U.S., public shareownership will continue to be dominant.

8. The public markets are not at all less essential because of increased activity in the private markets, primarily for two reasons. First, because I do not believe that the publicly owned corporation is being eclipsed; and second, because of liquidity. Facilitating capital formation and providing liquidity were the primary reasons for establishing the public markets. From an investor's viewpoint, if the only investments available were in the illiquid (and therefore more risky) private markets, most investors would remain heavily invested in cash instruments. For corporations, there would be less capital available, and it would be more expensive. Also for growth companies, the public markets will always be important sources of capital.

For the future, there may have to be some evolution in the public markets to ensure that they meet the needs of both investors and corporations, but I do not believe that they will be any less necessary than they are today.

9. The situation should be not much different than it is today. Fewer large institutions might be investing their capital in small companies, but more and more dollars invested passively would create profit opportunities in investment in companies not included in the indexes. Market forces nearly always assure that capital will be forthcoming from investors looking for a profit if a profit opportunity exists. In addition, broader market index funds often include smaller companies; for example, some funds invest to replicate the returns of the Russell 3000 index.

10. I believe that the role of index funds in the markets may be becoming overplayed. Market prices will continue to be set by supply and demand, and active investors will continue to be the ones who determine the supply and demand at the margin. There is no evidence whatsoever that index investing will take over the markets. It is merely a cost-effective way to invest in a broad spectrum of American companies. Greater profit opportunities will attract investors into and out of indexing as the costs of active and passive management rise and fall relative to their expected returns.

11. There is no contradiction. Indexing is primarily used for two reasons. First, many investors do not believe that an investor can better the market averages over time, since by definition the market returns are the aggregation of all individual returns. Second, it is a convenient way to invest in a broad section of the markets, and it is cost-effective, primarily because trading activity is so low.

If institutions are invested in indexes, because they see that as the most cost-effective and efficient way to invest, they are almost certainly extremely long-term owners of the stocks in the indexes. Access to the proxy process, by which the corporation owners might gain a stronger voice, is therefore quite consistent. It is also true that many large index fund managers are also active managers for other clients, and therefore the research that is essential for responsible proxy voting is accessible to those who vote the proxies for the index fund accounts.

Even if institutions are invested in index funds for these reasons, they are still concerned with the viability of each investment. The proxy vote is part of the price of a share of stock and can have economic impact. Some institutional holders have broader agendas than pure investment, and may be more vociferous in dealing with corporate governance issues.

12. Clear and frequent communication with shareholders is essential for investors to understand long-term value potential, especially when strategies and investments by the corporations may detract from short-term earnings performance. In addition, corporate managements ultimately must deliver economic benefits to the shareholders: every long-term investment is not necessarily a good investment simply by virtue of being long-term.

13. My opinion is that the "control premium" is most often a reflection of differing judgements about the value of the ongoing business and its assets (see question 1). I do not believe that breakup value is in itself a source of value, although it may occasionally be perceived that eliminating inefficient combinations would increase value.

14. Corporate governance is something that should be the purview of Boards of Directors and the corporation's shareowners. Shareowners already have the right, through the proxy process, to elect directors and voice their views on the issues. I do not advocate federal involvement.

15. We definitely need more information in this area. There are far too few facts on turnover, and far too many allegations and extrapolations being made without facts. In the Brancato study specifically, some of the figures represent only a small portion of the assets of the institutions listed, and the degree to which the data are

an accurate reflection of reality is debatable. In addition, the measurement process is difficult and can yield misleading results: for example, investing new funds or disinvesting to pay benefits are parts of traditionally measured turnover figures. It would be detrimental to pension funds to make these necessary activities more difficult and costly in an effort to curtail turnover.

It is important that we do not approach the turnover question without thoughtful study. We should not outlaw selling stocks, or make it so difficult that the result is the same; our markets will suffer if we do. The public market system works, after all, by allowing buying and selling. We should also be careful in making judgements about turnover: in deciding what level of turnover is "too" high, and in deciding who should make that judgement. Some level of turnover benefits market efficiency and the cost of capital for corporations (by providing liquidity). Focusing unduly on turnover statistics exposes us to the risk of undermining the competitiveness of our corporations.

For pension funds, it should be noted that pension funds are highly diversified across a broad array of investment classes, including real estate and other private market investments. Turnover across total funds is likely lower than it was 10 to 20 years ago.

A better approach than focusing solely on turnover might be to try and discover how long stocks are owned, rather than how often some average is turned over. But again, we are in danger of deciding (and imposing that decision on others) how long is long enough.

16. 39% seems surprisingly high to me, and does not reflect our experiences in CIEBA. We have thoroughly reviewed and discussed proxy voting by our investment managers, and our discussions indicate that our managers explicitly understand the importance of proxy voting and the standards by which they must evaluate proxy issues.

17. I do not agree. ERISA (wisely, in my opinion) does not dictate investment strategies or limit investment options. Instead, it allows flexibility, and thereby allows investment strategies to evolve with the markets. Many investment options available today were not in existence in 1974.

If by "wider range of choice" the question means the flexibility to choose long-term value over short-term gain, or the flexibility to make decisions with an eye toward what those decisions might mean to the capital markets and the economy, an amendment to ERISA is not necessary. The law is already consistent with that perspective. (See question 4.)

If the question refers to social and economic "greater good" issues, then I do not believe that ERISA should be amended, nor should fiduciaries be encouraged, to direct pension dollars into those areas. (See question 4.)

18. At this point I see no evidence of the need for any changes, particularly not for ERISA (see questions 4, 6, and 17). The market forces are functioning and may necessitate some evolution in the markets, but I do not see the need for intervention.

19. I believe that we do have a responsibility to be aware of what impact our actions as large investors might have on the markets. As I mentioned in the hearing, AT&T has made decisions on that basis; for example, we decided not to utilize portfolio insurance strategies because we were concerned about the strategy's efficacy in down markets, and about our own impact if we were selling in an already falling market. I believe studies on market volatility such as that being sponsored by the New York Stock Exchange are to be applauded. The root causes and desirability of any "fixes" should be studied carefully, and decisions should be made based on fact, not allegations and misconceptions.

20. I can only speak for private pension funds, and we do not believe that criticism is valid. We invest to fund liabilities that stretch 50 years and more into the future. Those of us who hire outside investment managers evaluate their performance over a 3 to 5 year period or longer, and we do not make hire-or-fire decisions based on short-term results.

I urge caution in attempting to "encourage" long-term holding of equity securities. Most attempts to do that are in reality ways to *dis*courage short-term holding. The only real and lasting way to encourage long-term holding is for there to be an appropriate return expected for the long-term holding, and short of devising a tax code solution, which I do not feel should be done, the government cannot provide an appropriate return. The companies must do that, and in the process, they will become more competitive globally.

Discouraging short-term holding in the absence of corporate actions to provide an appropriate long-term return is a market distortion and should not even be considered. Taxation as a means can have dire consequences for the competitiveness of American corporations, for retirement benefit security, or for both. Frequent and open communication between management and owners will help investors have a better understanding of management's longer-term strategies, and help managements better see investors' concerns.

21. Neither active nor passive investment strategies are contrary to fiduciary responsibilities. Both are prudent investment strategies that can provide the best long-term return to a pension fund subject to its size and risk tolerance.

22. We are not necessarily in favor of some forms of "investor activism," but such investors' intent can be defended on the grounds that as long-term investors, they are attempting to improve management performance rather than sell the stock. It is the purview of management

to run a company, and any investor must take care with how we intervene in the process. The most effective corporate governance mechanism is an involved and responsive board of directors, and the proxy process provides the means for investors to have a voice in that.

In the case of an underperforming company, the fiduciary must decide on a case-by-case basis whether to hold or sell, and the fiduciary obligation is not weighted toward either option. If the investment manager sees promise for longer-term value, he can be entirely consistent with his fiduciary duties in deciding to hold the stock.

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